I. INTRODUCTION

Although the Tribunal in its Procedural Order of February 27, 2001 directed that the July hearing will not include any factual or expert testimony, the United States included in its Reply of April 12 a second Expert Report from Prof. Detlev Vagts. Consequently, Methanex has attached to this Rejoinder the Comments of Sir Robert Jennings, former President of the International Court of Justice (attached as Exhibit 1), which are joined in by Sir Ian Sinclair, former Legal Advisor to the Foreign and Commonwealth Office (attached as Exhibit 2). As discussed in more detail below, Sir Robert concludes, in contrast to Prof. Vagts, that there is a general international law obligation of good faith and reasonableness. With respect to Archer-Daniels-Midland's campaign contributions to and secret meeting with Gov. Davis, he concludes that there clearly exists a valid and substantial issue as to whether there has been a violation of NAFTA's fair and equitable standard.

II. RELEVANT FACTS[1]

A. The Market for Gasoline Oxygenates

Oxygenates are substances that cause gasoline to burn more cleanly. *See* Energy Information Administration, *International Energy Annual 1999*, Glossary ("IEA Glossary"). As a result of the Clean Air Act Amendments of 1990 ("CAAA"), the U.S. Environmental Protection Agency ("EPA") requires the use of "reformulated gasoline" in areas with heavy air pollution, including many areas in California. Reformulated gasoline has oxygenate content levels specified by the EPA. *Id.*

[1] Methanex incorporates by reference the facts set forth in its Draft Amended Claim and its earlier pleadings in this case. Methanex believes that under the Tribunal's February 27, 2001 Order, these facts must be accepted as true for the purposes of the Tribunal's consideration of the jurisdictional challenges of the United States.

1. Types of Oxygenates

The United States defines "common" oxygenates as including "ethanol, methyl tertiary butyl ether ('MTBE'), ethyl tertiary butyl ether ('ETBE'), and methanol." IEA Glossary. Of these, the United States defines MTBE as a "methanol derivative," (U.S. Int'l Trade Comm'n, *Methyl Tertiary-Butyl Ether (MTBE): Conditions Affecting the Domestic Industry*, Investigation No. 332-404 at F3 (Sept. 1999) ("ITC")), and ETBE is referred to as a derivative of ethanol. Carroll E. Georing, *Tapping a Renewable Energy Source*, 34 Ill. Research 10, 11 (Spring/Summer 1992). Although these and other chemicals can serve as an oxygenate, the market has winnowed the effective competitors to three: MTBE, ETBE, and ethanol.

2. Oxygenate Production Processes

The two oxygenates that are alcohols — methanol and ethanol — can be used directly as oxygenates. Methanol is generally produced from natural gas, and ethanol is primarily derived from corn. ITC at 3-37, D-2.

Methanol and ethanol are also feedstocks for their derivative ether oxygenates — MTBE and ETBE respectively. The production process for MTBE and ETBE is essentially identical. In simple terms, the alcohol (methanol or ethanol) is combined with isobutylene to form the derivative ethers (MTBE or ETBE). Cal. Air Resources Bd., *An Overview of the Use of Oxygenates in Gasoline* at 22 (Sept. 1998); ITC at 3-40. Plants producing MTBE can easily be converted to produce ETBE. ITC at 3-41.

3. Oxygenate Consumers

Gasoline refiners and distributors blend oxygenates with gasoline in order to produce reformulated gasoline. The methods for producing oxygenates and blending them into gasoline vary depending upon the type of oxygenates used and, most importantly, the type of oxygenate

consumer. The two most important groups of oxygenate consumers are captive oxygenate producers and gasoline blending plants.

a) Captive Oxygenate Producers

Captive oxygenate producers are petroleum refineries that have vertically integrated the production and blending of oxygenates into their core petroleum refining operations. *See* ITC at 3-7; United States Energy Information Administration, *Petroleum Supply Annual 1999*, at 166; Macdonald Aff. ¶ 3 (attached as Ex. 3). These refineries produce a captive stream of isobutylene, combine the isobutylene with methanol or ethanol to form MTBE or ETBE, and blend the oxygenate with gasoline to create the final reformulated gasoline product. Instead of producing MTBE or ETBE, these refiners may instead choose to "splash blend" ethanol into gasoline at their distribution terminals. Captive oxygenate producers account for approximately 50 percent of MTBE production and consumption in the U.S. and California. EIA-819M Monthly Oxygenate Telephone Report data: Monthly Methyl Tertiary Butyl Ether (MTBE) Production by Merchant and Captive Plants (Mar. 2001); ITC at 3-2. Over the last two years, Methanex has supplied methanol to at least five captive refinery oxygenate plants in California. Macdonald Aff. ¶ 4.

Thus, captive oxygenate producers that sell reformulated gasoline have a binary choice: buying methanol or buying ethanol. As California's MTBE ban goes into effect, these refineries and their methanol providers have had to reduce their reliance on methanol and begin relying upon other oxygenate sources.

b) Gasoline Blending Plants

Gasoline blending plants and distributors do not have access to a captive stream of isobutylene, but instead purchase oxygenates for blending with their gasoline. Gasoline blending plants in California have relied primarily on MTBE as the oxygenate of choice, purchasing

MTBE from merchant MTBE producers. As the California MTBE ban takes effect, however, ethanol sales will increase and MTBE sales will decrease.

Because MTBE is a derivate of — and chemically manufactured from — methanol, sales of ethanol to gasoline blending plants directly displace sales of methanol to MTBE producers. There is virtually a one-to-one correspondence: for each sale of ethanol to a California gasoline blending plant, methanol producers will lose a sale to merchant MTBE producers. *See* Macdonald Aff. ¶ 9. Thus, it is reasonably foreseeable that the increased sale of ethanol for use as an oxygenate will displace methanol in the oxygenate market. And it is even more foreseeable that a prohibition on MTBE will harm producers of methanol.

4. The U.S. Agrees That Ethanol Displaces Methanol

The United States itself *actually foresaw* that limitations on the use of MTBE would increase sales of ethanol as an oxygenate and displace sales of methanol and MTBE. In 1993, the EPA proposed a requirement that 30 percent of the oxygenate content for U.S. reformulated gasoline be reserved for "renewable oxygenates" such as ethanol. *See* 58 Fed. Reg. 68,343 (Dec. 27, 1993) (Notice of Proposed Rulemaking). In so doing, the EPA made the familiar protectionist argument that "the use of domestic, renewable ethanol would clearly reduce high value energy imports relative to imported methanol or MTBE." *Id*. at *4. "Money now spent on imported oil or oxygenates could instead be spent for renewable fuels made from feed stocks currently grown or processed in the United States. This would keep capital in the United States, provide domestic jobs, strengthen our national security, and support a wide variety of American agricultural and fuel industries." *Id*. at *3. Several members of Congress enthusiastically supported the program because it would provide "a significant new market for ethanol." 59 Fed. Reg. 39,258, 39,262 (Aug. 2, 1994) (Final Rule).

The EPA recognized the obvious economic impact of its proposal to expand the ethanol market by government fiat: "The revenues and net incomes of both corn farmers and ethanol producers should rise significantly, due to higher corn and ethanol demand and prices, respectively." 58 Fed. Reg. 68,343 at *13. It also saw the necessary corollary, that competing methanol producers would be harmed: "Revenues and net incomes of domestic methanol producers and overseas producers of both methanol and MTBE would likely decrease due to reduced demand and prices." *Id.* The United States considered these damages to be among "[t]he primary economic impacts of this proposal." *Id*. at *12.

Opponents challenged the EPA proposal, arguing that it was bad environmental policy, politically motivated, and "simply designed to funnel hundreds of millions of dollars to Archer-Daniels-Midland Co., the primary maker of ethanol." Frank Swoboda and Daniel Southerland, *Court Bars EPA From Mandating Ethanol Use*, Wash. Post, Sept. 14, 1994, at A8; *see also* Arthur Gottschalk, *Federal Court Ruling Clouds the Outlook for Ethanol Interests*, J. Com., Sept. 19, 1994, at 5B. A U.S. Court of Appeals invalidated the proposal because the EPA had no statutory authority to promulgate such a rule if, as the EPA itself conceded, the "use of ethanol might possibly make air quality *worse*." *Am. Petrol. Inst. v. EPA*, 52 F.3d 1113, 1119 (D.C. Cir. 1995) (emphasis added).

B. Methanex Has Already Been Damaged By The California Ban

1. The Ban Has Caused An Immediate Decrease In MTBE Consumption

When Governor Davis issued his Executive Order, most California gasoline contained MTBE. *See* California Environmental Protection Agency, *Basis for Waiver of the Federal Reformulated Gasoline Requirements for Year-Round Oxygenated Gasoline in California*, at *1-2. Governor Davis did not intend that this widespread use of MTBE in California would continue until the stroke of midnight, January 1, 2003, and then end all at once. Instead, his

preference was "to eliminate MTBE from California gasoline immediately" (*Basis for Waiver*, at *2), and he therefore directed a "rapid phase down" of MTBE in California. Letter from Governor Davis to Carol M. Browner, Administrator, U.S. EPA (Apr. 12, 1999) at 1; *see also Basis for Waiver*, at *5. California regulatory officials have stated that "there will be a major effort to eliminate the use of MTBE in various areas of the state considerably before December 2002." *Basis for Waiver*, at *7. Indeed, as early as April 12, 1999, California already had recognized that "the state *is* rapidly phasing-out MTBE from all California gasoline." *Id*. at *5 (emphasis added).

As intended by California officials, the impact of the California ban has been immediate. In fact, Methanex experienced a 12 percent decrease in its methanol sales to captive oxygenate producers between 1999 and 2000. *See* Macdonald Aff. ¶ 10. At least one producer has announced that it will permanently close an MTBE facility because of the California ban, and will permanently cease methanol purchases well before the scheduled termination date in the first half of 2002. *See* Rahkamo Aff. ¶ 3 (attached as Ex. 4). In short, the declining demand for MTBE and methanol has already begun, and will only accelerate as the final phase-out date approaches.

2. The Immediate Drop In Methanex's Market Value Confirms Its Immediate Damage

The announcement of the MTBE ban caused an immediate and precipitous decline (and has had a continuing impact) on Methanex's market valuation. As set forth in the Draft Amended Claim, the day after Governor Davis' Executive Order was issued, the trading volume in Methanex shares on the Toronto Stock Exchange was nine times the average of the preceding four days. Over the next ten days, the average share price was almost 20 percent less than the average share price from the ten days preceding the ban. *See* Draft Am. Claim at 37. This

immediate decline in market price represented a loss to Methanex and its shareholders of approximately $120,000,000.

The effects of this decline on Methanex's share value are continuing. Historically, Methanex's share price has tracked the price of its only product - methanol. That historical correlation, however, was *permanently discounted* by California's MTBE ban. *See* Draft Am. Claim at 37. If the California measures had not been implemented, Methanex's market capitalization would now be worth approximately $1 billion more. This decline in Methanex's market value is evidence of: (1) the fact that the California ban directly caused *immediate damage* to Methanex; (2) the *direct causal connection* between Governor Davis' Order and the damages to Methanex; and (3) the *amount* of damage or loss caused by the California ban.

C. The California Waiver Request

When it banned MTBE, California requested a waiver from the reformulated gasoline program so that it would not be required to use *any* oxygenates in its gasoline. *See* Letter from Governor Davis to Carol M. Browner, Administrator, U.S. EPA (Apr. 12, 1999). The waiver request confirms California's knowledge that MTBE and ethanol compete directly in the marketplace. It also confirms that domestic ethanol producers were the intended beneficiary of California's ban.

California sought the waiver because the U.S. ethanol industry was simply incapable of satisfying the demand for oxygenates after the MTBE ban:

> If MTBE is completely phased out of California gasoline in about three years and the federal RFG oxygen mandate is not waived, California refiners would need as much as 75,000 barrels of ethanol per day to meet demand according to the CEC Report. The United States produces about 80,000 barrels per day of ethanol to meet current demand for all uses, with another 30,000 barrels per day of spare production currently idle. California will have to compete with other states if ethanol demand increases dramatically.

Basis for Waiver, at *6. Nonetheless, the waiver request emphasized that the U.S. ethanol industry would be the primary beneficiary of the MTBE ban, *with or without the waiver*:

> One final aspect of an oxygen waiver bears emphasis—even with a waiver of the federal RFG oxygen mandate, *a significant portion of California gasoline would still contain ethanol*. . . . Moreover, ethanol would still be needed to meet the continuing requirement for oxygenated gasoline in the winter in the greater Los Angeles area. (Emphasis in original).
>
> . . .
>
> (E)ven without an oxygen mandate, ethanol as the most likely oxygenate substitute for MTBE would be expected to be in widespread use in California because of the continuing wintertime oxygenates requirements in the Los Angeles area and the octane benefits provided by ethanol.
>
> . . .
>
> It is ARB's understanding that ethanol is the only oxygenate being seriously considered by California refiners to be used in place of MTBE.

Basis for Waiver, at *4, *5, *7.

Even though the U.S. ethanol industry would still be the primary beneficiary of the MTBE ban, it has bitterly opposed the California waiver. *See, e.g.*, News Release, Nebraska Corn Board (Apr. 4, 2001) ("tell [the White House] that corn growers will be irreparably harmed if the California waiver is granted"); News Release, Office of U.S. Congressman Tom Latham (Iowa) (Feb. 15, 2001) (releasing letter to Christie Todd Whitman, the new Administrator of the EPA, asking that she deny California's waiver request and encourage the state to replace MTBE with ethanol). The domestic ethanol industry thus continues to demand the maximum possible government promotion and protection.

D. Archer-Daniels-Midland's Secret Meeting With Governor Davis

ADM not only made substantial campaign contributions to Governor Davis, but also held a key secret meeting with him. That meeting took place at a critical time in the development of

oxygenate policy, and in circumstances suggesting that ADM misled and improperly influenced the Governor.

The meeting was deliberately kept secret when it was held, and the participants continue to this day to deny what it was about. Although Gray Davis was at the time both the incumbent Lieutenant Governor of California and an active candidate for election as Governor, the meeting was never disclosed by either his California state office or his campaign organization, and was deliberately kept secret by both entities.[2] In fact, Lieutenant Governor Davis' August 1998 trip to Illinois was reported on campaign finance filings as a meeting in Chicago with labor representatives — a studied effort to hide from public scrutiny the additional "side trip" to Decatur, Ill., the site of ADM's corporate headquarters. *See* Gray Davis' California Form 490 Schedule E, 7/01/98-9/30/98, at 4.

Nor did ADM disclose the August 4, 1998 meeting in Decatur. Indeed, to this date, ADM officials continue to dissemble about the August 4, 1998 meeting. After the United States provided Methanex's January 12, 2001 Outline of its Draft Amended Claim to an organization seeking *amicus curiae* status in this proceeding, that outline was posted on the Internet and reported in the press. ADM's first response was a statement attributed to a "top official" that "we don't hold secret meetings." InsideEPA.com Today (Mar. 7, 2001). That assertion, which is belied by ADM's history of numerous secret meetings to illegally fix the price of various agricultural commodities,[3] was quickly followed by another false statement:

> The U.S. agricultural giant [ADM] does extensive food business in California so it was only "only natural" to have met with Governor Gray Davis during the 1998 campaign and contribute $200,000 to

[2] Methanex has unsuccessfully sought access to records concerning the secret meeting under California Public Records Act, Cal. Gov. Code § 6250 *et seq*.

[3] *See United States v. Andreas*, 216 F.3d 645, 652, 654 (7th Cir. 2000).

> his coffers, ADM spokesman Larry Cunningham said. "Our contributions are public knowledge," Cunningham told Reuters, adding that the meeting with Davis at ADM's Illinois headquarters was a "get acquainted session.

ADM Denies Methanex Charge on California Campaign Cash, Reuters English News Service, Mar. 12, 2001 (emphasis added).

ADM's characterization of the secret meeting as a "get acquainted session" is directly contradicted by the responsibilities and job titles of the ADM representatives who attended the meeting with Governor Davis. As the *Wall Street Journal* reported, those who attended the meeting "were mostly tied to the ethanol industry:"

> According to an itinerary of the Aug. 4 visit, two of the seven officials scheduled to attend were ethanol-industry executives and two more were Archer-Daniels senior executives heavily involved in that company's ethanol business.

Gray Davis Denies Improper Influence After Meeting With ADM Is Revealed, Wall St. J., Mar. 30, 2001. By contrast, it appears that no one involved in ADM's allegedly "extensive food business" in California attended the secret meeting.[4]

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[4] Governor Davis's dealings with ADM appear to be part of a broader practice of affording favorable access and regulatory treatment to large campaign contributors. As one journalist has explained:

> During the first year of his governorship, Davis pulled in a record $14 million from a wide variety of special interest groups, averaging more than $38,000 a day, or $1,600 an hour.
>
> * * * *
>
> [A] certain pattern developed. Farmers, timber company executives, leaders of the managed health care industry or other interest groups would stage fund-raising events for Davis in conjunction with their discussions of pending issues and by some coincidence, he would soon adopt policies that found favor with the interest groups involved. The most obvious example involved health care company regulation, with Davis insisting on a final

III. LEGAL ARGUMENT

A. Methanex Satisfies Any Conceivable Causation Standard

Regardless of the standard of causation that this Tribunal ultimately determines is required under NAFTA, Methanex has already alleged facts sufficient to meet the proximate causation standard urged by the United States. However, the text of NAFTA clearly provides a lower causation standard, and the United States in any event concedes that it is liable for any intentional harm. Thus, Methanex's allegations of harm easily satisfy any causation standard.

1. The California MTBE Ban Proximately Caused Methanex's Damages

The United States asserts that it is liable only for damages that are the "reasonably foreseeable" (U.S. Reply Mem. at 9, n.9) or "reasonably direct and obvious" (*Id*. at n.10) consequences of its NAFTA violations. Other international authorities similarly define proximate cause: "According to principles recognised both by municipal and international law, the indemnity due from one who has caused injury to another comprises all loss which may be considered as the *normal consequence* of the act causing the damage." *Antippa (The Spyros) Case* (Greco-Germ. Mixed Arbitral Trib.) (1926) (emphasis in the original) (as *quoted in* Bin Cheng, *General Principles of Law as Applied by International Courts and Tribunals* 249

(continued…)

> version that the companies could tolerate, but that health consumer advocates found wanting.
>
> * * * *
>
> Lobbyists believe that the surest way to get Davis' attention is to stage a fund-raising event. And Davis political aides, lobbyists say privately, make it clear that the minimum required for a personal appearance by the governor is $100,000, four times his threshold as a candidate in 1998.

Walters, Is It all Simply A Coincidence?, *Sacramento Bee* (June 23, 2000).

(1953)). "[T]he duty to make reparation extends only to those damages which . . . would normally flow from [an unlawful] act, or which a reasonable man in the position of the wrongdoer at the time would have foreseen as likely to result, as well as all intended damages." Cheng, *General Principles of Law* at 253. Evidence that a particular result was actually foreseen satisfies the proximate cause standard. "[I]ndeed, it would not be equitable to let the injured party bear those losses which the author of the initial illegal act has foreseen . . . for the sole reason that, in the chain of causation, there are some intermediate links." *Angola Case* (Port.-Germ. Arbitral Trib.), Award I (1928) (as *quoted in* Cheng, *supra*, at 242).

These standards are readily satisfied here. As explained above, the MTBE ban already has caused some oxygenate producers and consumers to shift away from Methanol. *See supra* at pp. 3-4. That was its intended effect. Indeed, the United States does not and cannot assert that oxygenate producers had any alternative other than reducing methanol purchases, including purchases from Methanex. Similarly, the MTBE ban has increased ethanol consumption by independent gasoline blenders, which directly and foreseeably displaced methanol sales to merchant MTBE producers. The United States does not dispute these economic impacts, which it has actually foreseen. Long ago, the EPA recognized that increased use of ethanol as an oxygenate would decrease "revenues and net incomes of domestic methanol producers and overseas producers of both methanol and MTBE" (58 Fed. Reg. 68,343 at *13), and that these harms to methanol producers would be among the "primary economic impacts" of its proposal to favor ethanol as an oxygenate. *Id.* at *12. In light of the EPA's conclusions in 1993, the U.S. cannot credibly assert that it was unforeseeable that an MTBE ban would damage methanol producers.

The United States errs in its contention that the proximate cause standard cannot be satisfied because Methanex's injuries are "too indirect." U.S. Reply Mem. at 7. In fact, its own

authority rebuts the premise that proximate cause turns on mechanistic characterizations of injury as "direct" or "indirect":

> the familiar rule of proximate cause—a rule of general application both in private and public law— . . . [i]t *matters not whether the loss be directly or indirectly sustained so long as there is a clear, unbroken connection* between Germany's act and the loss complained of. It *matters not how many links there may be in the chain of causation* connecting Germany's act with the loss sustained, provided there is no break in the chain and the loss can be clearly, unmistakably, and definitely traced, link by link, to Germany's act.

Administrative Decision No. II (Germ.-U.S. Mixed Claims Comm'n 1923) 7 R.I.A.A. 23, 29-30 (emphasis added). Because its injuries were reasonably foreseeable as a result of the MTBE ban, Methanex readily satisfies any possible standard of proximate cause.

2. NAFTA's Text Expressly Creates A Lower Causation Standard

In any event, Methanex need not satisfy a proximate cause standard. Under NAFTA Articles 1116 and 1117, the United States is liable for damages that Methanex has suffered "by reason of, or arising out of" a breach by California. The treaty language includes two separate phrases, separated both by commas and by the word "or." These two separate phrases create two separate causation standards.

The United States urges the Tribunal to simply read the second phrase out of the Treaty. U.S. Mem. at 16. Specifically, it contends that the word "or" means "synonymous with," and that the two treaty phrases — even though juxtaposed against each other — have precisely the same legal meaning. The argument has no merit.

It is a universally accepted interpretive principle that *all* the words and phrases of a legal instrument must be given meaning. "[A] legal text should be interpreted in such a way that a reason and a meaning can be attributed to *every word in the text*. It may be said that this principle should in general be applied when interpreting the text of a treaty." *Anglo-Iranian Oil*

Co. (U.K. v. Iran), 1952 I.C.J. 93, 105 (July 22) (emphasis added); *see also* 1 L. *Oppenheim*, *International Law* § 554(12) (H. Lauterpacht ed., 8th ed. 1955) ("It is to be taken for granted that the parties intend the provisions of a treaty to have a certain effect, and not to be meaningless. Therefore, an interpretation is not admissible which would make a provision meaningless, or ineffective.").

Similarly, it is axiomatic that treaty terms should be given their ordinary meaning. Under Article 31(1) of the Vienna Convention, international agreements "shall be interpreted in good faith *in accordance with the ordinary meaning* to be given to the terms of the treaty in their context and in the light of its object and purpose." Art. 31(1) Vienna Convention on the Law of Treaties, U.N. Doc. A/CONF. 39/27 (1969) (emphasis added). *See also* Oppenheim, *supra* § 554(2) ("The terms used in a treaty must be interpreted according to their usual meaning in the language of everyday life, provided that they are not expressly used in a certain technical meaning, or that another meaning is not apparent from the context"). The "ordinary" meaning of a word is expressed in preferred or initial dictionary definitions. *See Hutchins v. Champion Int'l Corp.*, 110 F.3d 1341, 1344 (8th Cir. 1997) ("Ordinary meaning is determined by the dictionary definition of the word and the context in which it is used."); *Encarta World English Dictionary* (1999) ("Senses are ordered according to usage and frequency.").

The ordinary meaning of "or" is to separate alternatives, not to introduce synonyms. Every dictionary cited by the United States itself shows the preferred definition of "or" — its ordinary meaning — is to introduce alternatives, not synonyms. *Only* the secondary definitions of "or" cited by the United States mean "synonymous with," and secondary definitions are not indicative of ordinary usage. Therefore, both as a matter of grammar and logic, the ordinary meaning of "or," in the phrase "by reason of, or arising out of," is to denote two alternative standards of causation.

As Methanex also demonstrated in its Counter-Memorial, the phrases "by reason of" and "arising out of" have distinct, but commonly understood legal meanings. The phrase "by reason of" is generally understood to refer to the proximate cause standard advocated by the United States. *See* Methanex Counter-Mem. at 34. "Arising out of," on the other hand, refers to a lesser degree of causal connection. *See id*. at 31-34. This distinction is reflected in the decisions of municipal courts in Canada, Great Britain, Australia, and the United States in a variety of legal settings.

These separate meanings are reinforced because the two phrases have been juxtaposed against each other in the same legal text. Indeed, virtually every English-speaking jurisdiction has concluded that when these two or similar phrases are used together, they *must* have separate meanings.

> The words "arising out of" in s. 10 of the Act and in the indemnity clause of the policy are not merely, if at all, explicative of the words "caused by"; they are really used in contrast to them; and in the total expression are extensive in their import. Bearing in mind the general purpose of the Act, I think the expression "arising out of" must be taken to require a less proximate relationship of the injury to the relevant use of the vehicle than is required to satisfy the words "caused by".

Gov't Ins. Office v. R.J. Green & Lloyd Pty. Ltd, (1966) 114 C.L.R. 437 ¶ 10 (New South Wales) (Barwick, C.J., Judgement 1).

> The words "arising out of the use" have no doubt a wider connotation than the words "caused by . . . the use". To my mind, however, they do import a relationship between the use of the vehicle and the injury which has some causal element in it.

Id., ¶ 5 (Menzies, J., Judgement 4).

Despite erroneously characterizing these principles as "insurance law" (U.S. Reply Mem. at 6-7), the United States does not proffer a *single* authority, from *any* international court, commentator, or court of *any* English speaking nation, supporting its argument that the two

phrases "by reason of, or arising out of," when juxtaposed, mean precisely the same thing. Instead, the best the United States can provide are a mere two citations to authorities that interpret the phrase "arising from" or "arising out of" — when standing alone — as equivalent to proximate cause. *Id.* at 8 n.8 (discussing Algiers Accord); *id.* at 12 n.15 (separate opinion of Judge Sir Gerald Fitzmaurice). Even more inapposite is the *H.G. Venable* case, which involved an "originating from" causation standard not at issue here, and which held Mexico "indirectly liable" for the damages at issue. *H.G. Venable* (U.S. v. Mex.), (Mexico-V.T. Claims Comm'n (1927)) 4 R.I.A.A. 219, 229. Finally, *Hoffland Honey Co. v. National Iranian Oil Co.*, 2 Iran-U.S. Cl. Trib. Rep. 41 (1983) is simply not persuasive authority due to the "silly" claim involved there. *See* C. Brower & J. Brueschke, *The Iran-United States Claims Tribunal* 459 (1998) ("The Tribunal . . . rightly denied a rather silly claim of a Wisconsin beekeeper. . . . [because] the sales of Iranian oil were a 'cause' of the claimant's loss only in the sense that 'had there been no oil, and thus no chemicals, the loss would not have occurred.") Such scant and inapposite authority is hardly a sufficient basis for this Tribunal to eliminate the separate phrase "or arising out of" from the text of NAFTA.

Finally, under any causation standard (even the "reasonably foreseeable" and "reasonably direct" standards advocated by the United States), the causation inquiry ultimately turns on the degree of directness and foreseeability between the California MTBE ban and the resulting injuries to Methanex. That fact-intensive and merits-focused debate cannot possibly be resolved against Methanex as a "jurisdictional" matter, at this preliminary stage of the case, based only on the pleadings.

B. The U.S. Denied Methanex National Treatment

Article 1102 establishes a national treatment obligation for investors of another NAFTA Party and their investments. In pertinent part, Article 1102(1) requires each Party to accord to

investors of another Party "treatment no less favorable than it accords, in like circumstances, to its own investors." Article 1102(2) similarly requires each Party to accord to investments of investors of another Party "treatment no less favorable than that it accords, in like circumstances, to investments of its own investors." Article 1102(3) further states: "The treatment accorded by a Party under paragraphs 1 and 2 means, with respect to a state or province, treatment no less favorable than the *most favorable treatment* accorded, in like circumstances, by that state or province to investors, and to investments of investors, of the Party of which it forms a part" (emphasis added).

A measure violates Article 1102 if: (1) foreign investors or their investments are in "like circumstances" with U.S. investors or investments, i.e., they operate in the same business or economic sector; (2) a measure discriminates against foreign investors or their investments on its face, or the government intended the measure to discriminate against foreign investors or their investments, or the measure has the potential effect of discriminating against foreign investors or their investments; and (3) the measure is unnecessary to protect the environment or human health. As explained below, Methanex has sufficiently alleged all these elements of an Article 1102 claim, and this Tribunal therefore has jurisdiction.

1. Methanex Is In "Like Circumstances" with U.S. Ethanol Producers

The "like circumstances" element of NAFTA encompasses all investors or investments that compete in the same business or economic sector. *See*, *e.g.*, *S.D. Myers, Inc. v. Canada*, (Partial Award Nov. 13, 2000), ¶ 250 ("The concept of 'like circumstances' invites an examination of whether a non-national investor complaining of less favourable treatment is in the same 'sector' as the national investor. . . . the word 'sector' has a *wide* connotation that includes the concepts of 'economic sector' and 'business sector.'"); *Pope & Talbot, Inc. v. Canada*, (Interim Award June 26, 2000), ¶ 78 ("In evaluating the implications of the legal

context, the Tribunal believes that, as a first step, the treatment accorded a foreign owned investment protected by Article 1102(2) should be compared with that accorded domestic investments in the same business or economic sector.").

Under this test, one key to determining whether the foreign investor and the domestic investor compete in the same market is whether they can take business away from each other. In *S.D. Myers*, Canada argued that Canadian waste remediation operators were not "in like circumstances" with S.D. Myers, an American investor, because S.D. Myers exported the waste to the U.S. for remediation, while the Canadian operators remediated the waste domestically. The tribunal considered this difference irrelevant to the "like circumstances" analysis. Instead, it held that S.D. Myers was "in like circumstances" with Canadian waste remediation operators because "SDMI was in a position to attract customers that might otherwise have gone to the Canadian operators," and that "[i]t was precisely because *SDMI was in a position to take business away* from its Canadian competitors that Chem-Security and Cintec lobbied the Minister of the Environment to ban exports when the U.S. authorities opened the border." *S.D. Myers*, ¶ 251 (emphasis added).

In the *Cross-Border Trucking* case, the United States similarly argued that because U.S. trucking firms operated under a stricter regulatory system than did their Mexican competitors, the Mexican and U.S. firms were not "in like circumstances." *In re Cross-Border Trucking Services*, (Award Feb. 6, 2001) ¶ 7. The Tribunal, however, rejected this distinction and held that the competing Mexican and U.S. trucking firms were "in like circumstances." *Id.* ¶ 259. The Tribunal reasoned that if "the regulatory systems in two NAFTA countries must be substantially identical before national treatment is granted, relatively few service industry providers could ultimately qualify." *Id.*

In this case, Methanex and its U.S. investments are "in like circumstances" with domestic ethanol producers because they compete in the same business sector — the gasoline oxygenate market — and because ethanol is in a position to take business away from methanol. As discussed above, captive oxygenate producers are faced with a binary choice between methanol or ethanol. *See supra* at p. 3. Thus, ethanol competes directly with methanol, and thus can "take business away" from methanol producers. Similarly, because ethanol sales to independent gasoline distributors will reduce methanol sales to merchant MTBE producers, ethanol again is in a position to "take business away" from methanol. The EPA's own conclusion bears repeating: "the use of domestic, renewable ethanol would clearly reduce high value energy imports relative to imported methanol or MTBE." 58 Fed. Reg. 68,343 at *4. (Notice of Proposed Rulemaking). Indeed, the regulations codifying the California ban specifically named ethanol as the replacement to MTBE. *See* Draft Am. Claim at 47. In fact, it is precisely because methanol and MTBE directly compete with ethanol that the U.S. ethanol industry has worked so hard to obtain preferential treatment from federal and state governments for ethanol, which otherwise cannot successfully compete with methanol and MTBE.

The United States, however, contends that the "like circumstances" test is not met because "[e]thanol and methanol are different products with different properties and uses, produced by industries in different sectors of the economy." U.S. Reply Mem. at 20. That assertion is wrong in every respect. As an initial matter, under Article 1102 the appropriate test is not whether ethanol and methanol are "like products," but whether their producers are "in like circumstances." Because those producers compete in the market for gasoline oxygenates, the "like circumstances" requirement is satisfied.

In any event, even if the "like products" test is applied here, this test is met because ethanol and methanol have identical end-uses and are used to a large degree by the same

consumers. *See United States - Taxes on Petroleum and Certain Imported Substances*, (GATT Panel June 17, 1987); BISD 34/136, 138 (finding that crude oil, crude oil condensates, and natural gasoline are "like products" with other hydrocarbon products because they "serve substantially identical end-uses"). Moreover, ethanol and methanol are "directly competitive or substitutable products." *EEC - Measures on Animal Feed Proteins*, (GATT Panel Mar. 14, 1978), BISD 25S/49, 50, ¶¶ 4.3, 4.8 ("The Panel concluded that vegetable proteins and skimmed milk powder were technically substitutable in terms of their final use and that the effects of the EEC measures were to make skimmed milk powder competitive with these vegetable proteins . . . The Panel concluded that the measures provided for by the Regulation with a view to ensuring the sale of a given quantity of skimmed milk powder protected this product in a manner contrary to the principles of [national treatment]").[5]

In short, whichever standard is used, Methanex is in "like circumstances" with U.S. ethanol producers, and ethanol is "like," or at least "directly competitive or substitutable," with methanol. Any doubt on this score should be resolved in favor of a comparison of foreign and domestic investment that is "most favorable to the investor." *See* K. Scott Gudgeon, *The United*

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[5] Professor Jackson cites an example in which apples and oranges can still be "like products" such that preferential treatment violates the national treatment principle:

> Let us suppose that some country in its negotiations has secured the binding of the duty on oranges. Country A gets a binding on the duty of oranges from Country B. Now, Country B after that can proceed to put on an internal duty of any height at all on oranges, seeing that it grows no oranges itself. But by putting on that very high duty on oranges, it protects the apples which it grows itself. The consequence is that the binding duty which Country A has secured from Country B on its oranges is made of no effect, because in the fact that the price of oranges is pushed up so high by this internal duty that no one can buy them. The consequence is that the object of that binding is defeated.

John H. Jackson, *World Trade and the Law of GATT* 282 (1969).

States Bilateral Investment Treaties: Comments on Their Origin, Purposes, and General Treatment Standards, 4 Int'l Tax & Bus. Law 105, 123 (1986) ("The concept of fairness and equity serves as a guide to interpreting and applying treaty provisions, such as the 'like situation' test discussed above, in a manner most favorable to the investor."). At a minimum, Methanex has raised a triable issue of fact on this issue, which cannot be resolved as a "jurisdictional" question based on the pleadings.[6]

2. California's Measures Discriminated Against Methanex and Its U.S. Investments

A measure may discriminate against a foreign investor or its investments in three different ways. First, it can discriminate against foreign investors on its face and thus constitute *de jure* discrimination. Second, it can discriminate against foreign investors by intentionally affording protection to the domestic industry. Third, it can have the effect of discriminating against foreign investors and thus constitute *de facto* discrimination. California's ban on MTBE is discriminatory in each way.

a) California's Measures Discriminate on Their Face

By its terms, Article 1102 prohibits measures that on their face provide "less favorable" treatment to foreign investors (or their investments) than to domestic investors (or their

[6] The inappropriateness of resolving the "like circumstances" analysis on the pleadings is underscored by the highly fact-intensive nature of that inquiry. *See, e.g., Pope & Talbot* (Phase 2 Award Apr. 10, 2001) ("*Pope & Talbot II*"), ¶ 75-76 ("It goes without saying that the meaning of the term will vary according to the facts of the case. By their very nature, 'circumstances' are context dependent and have no unalterable meaning across the spectrum of fact situations."); *S.D. Myers* ¶ 244 ("The [WTO] case law has emphasized that the interpretation of 'like' must depend on all the circumstances of each case. The case law also suggests that close attention must be paid to the legal context in which the word 'like' appears; the same word 'like' may have different meanings in different provisions of the GATT."); *Japan – Taxes on Alcoholic Beverages* (Appellate Body) WT/DS8/AB/R, ¶ 8.6 (Oct. 4, 1996) ("No one approach to exercising judgement will be appropriate for all cases . . . .The concept of 'likeness' is a relative one that evokes the image of an accordion.").

investments) in "like circumstances." Indeed, Canada conceded in *Pope & Talbot* that if a "measure is *de jure* discriminatory, it will violate Article 1102." *Pope & Talbot* (Phase 2 Award Apr. 10, 2001) ("*Pope & Talbot II"*) ¶ 56. Thus, if a measure is *de jure* discriminatory, there is no need to examine whether the measure was motivated by discrimination,[7] or whether the potential effect of the measure is discriminatory.[8]

The WTO Panel's decision in the *Asbestos* case is especially instructive. *See European Communities — Measures Affecting Asbestos and Asbestos-Containing Products* (Panel Report), WT/DS135/R, ¶¶ 8.154 - 8.157 (Sept. 18, 2000).[9] In that case, Canada challenged a French law prohibiting the import, production, and sale of asbestos and asbestos-containing products, but not products containing similar fibers like PVA, glass, and cellulose. After finding that all of these fibers were substitutable and therefore "like" products, the tribunal concluded that the asbestos ban constituted *de jure* discrimination.

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[7] "It is not necessary for a panel to sort through the many reasons legislators and regulators often have for what they do and weigh the relative significance of those reasons to establish legislative or regulatory intent. If the measure is applied to imported or domestic products so as to afford protection to domestic production, then it does not matter that there may not have been any desire to engage in protectionism in the minds of the legislators or the regulators who imposed the measure." *Japan-Alcoholic Beverages*, ¶ 8.26.

[8] "Having established *de jure* discrimination . . . we do not consider it necessary to determine whether there is any *de facto* discrimination between these products." *Asbestos*, ¶ 8.156.

[9] "NAFTA does not stand in isolation from other developments in international trade law. Many of the ideas and legal phrases in NAFTA are drawn from the global trade law system that used to be called the GATT system." *S.D. Myers* (separate opinion of Dr. Bryan Schwartz), ¶ 66. By adopting the "no less favorable" standard, the NAFTA Parties intended Article 1102 to be modeled on the identical national treatment language contained in GATT. In fact, Article 301(1) of NAFTA explicitly incorporates GATT Article III on national treatment. Accordingly, prior NAFTA tribunals have relied on GATT and WTO precedents in interpreting Article 1102 in the context of investments. *See Pope & Talbot II*, ¶ 68-69 (relying on the *Section 337* and *Malt Beverage* case); *S.D. Myers*, ¶ 244 (citing *Japan-Alcoholic Beverages* case); *Cross-Border Trucking*, ¶ 251 (discussing the *Section 337* case).

> We next note that the terms of the Decree in themselves establish less favourable treatment for asbestos and products containing asbestos as compared with substitutable fibres and products containing substitute fibres . . . *Inasmuch as the Decree does not place an identical ban* on PVA, cellulose or glass fibre and fibro-cement products containing PVA, cellulose or glass fibres, we must conclude that *de jure* it treats imported chrysotile [i.e. asbestos] fibres and chrysotile-cement products less favourably than domestic PVA, cellulose or glass fibre and fibro-cement products.

Id. ¶¶ 8.154, 8.155 (emphasis added);[10] *see also Cross-Border Trucking*, ¶ 278.

The California MTBE ban constitutes *de jure* discrimination because it discriminates in favor of domestic ethanol producers and against all competing foreign producers of methanol and MTBE. Apart from the ban of MTBE (but not ethanol), California further requires MTBE (but not ethanol) to be labeled at the pump. *See* Draft Am. Claim at 47. Thus, rather than granting methanol and MTBE producers the same treatment as domestic ethanol producers, as required under Article 1102, the MTBE ban singled out methanol and MTBE producers and investments for "less favorable treatment" than ethanol producers and investments. Under *Asbestos*, that is *de jure* discrimination.

Despite California's discrimination between foreign methanol producers and domestic ethanol producers, the United States contends that the MTBE ban is not discriminatory because it applies equally to domestic and foreign methanol investments. *See* U.S. Reply Mem. at 19. But under the international law of national treatment, it is entirely irrelevant whether the discrimination against foreign methanol producers and their investment also extends to domestic methanol producers. "The Panel did not consider relevant the fact that many of the state provisions at issue in this dispute provide the same [discriminatory] treatment to products of

other states of the United States as that provided to foreign products . . . Article III consequently requires treatment of imported products no less favourable than that accorded to the most-favoured domestic products." *United States — Measures Affecting Alcoholic and Malt Beverages*, BISD 39S/206, ¶ 5.17 (1992).

By its express terms then, Article 1102(3) requires a foreign investor or investment to receive the "*most* favorable treatment" afforded to any domestic investor or investment "in like circumstances" (emphasis added). Because methanol and ethanol producers are "in like circumstances," foreign *methanol* producers must receive the "most favorable treatment" afforded to domestic *ethanol* producers. As the *Pope & Talbot* tribunal explained, Article 1102 ensures to foreign investors or investments "the right to treatment equivalent to the '*best*' treatment accorded to investors or investments in like circumstances." *Pope & Talbot II,* ¶ 42. Furthermore, the national treatment analysis must also be applied in light of the purpose of Article 1102, which is to prevent measures that give protection to domestic investments. *See Malt Beverages*, ¶ 5.71 ("the purpose of Article III . . . is to ensure that internal taxes and regulation [are] '*not . . . applied to imported or domestic products so as to afford protection to domestic production*'") (emphasis added).

Because California treats foreign methanol producers and their investments less favorably than domestic ethanol producers and their investments "in like circumstances," and because the effect of the ban is to "afford protection" to U.S. ethanol producers, the ban constitutes *de jure* discrimination prohibited by Article 1102.

(continued…)

[10] The appellate body reversed the panel's "like products" determination, but left undisturbed its conclusion that disparate treatment among like products constitutes *de jure* discrimination. *See Asbestos*, WT/DS135/AB/R (Mar. 12, 2001).

b) California's Measures Were Intended To Benefit Domestic Ethanol Producers and Harm Foreign Methanol Producers

California's MTBE ban also violates Article 1102 because it was intended to protect the domestic ethanol industry. Such measures violate the plain language of Article 1102 by not according foreign investors and their investments the "most favorable treatment" afforded to domestic investors and their investments "in like circumstances." *See*, *e.g.*, *S.D. Myers* (separate opinion of Dr. Bryan Schwartz) ¶¶ 144-48 (protectionist intent or motive is "important" in determining whether a measure is discriminatory); OECD, *National Treatment for Foreign-Controlled Enterprises* 22 (1993) ("the key to determining whether a discriminatory measure applied to foreign-controlled enterprises constitutes an exception to National Treatment is to ascertain whether the discrimination is *motivated*, *at least in part*, by the fact that the enterprises concerned are under foreign control.") (emphasis added).

In *S.D. Myers*, the tribunal found a violation of Article 1102 based on evidence of protectionist intent. The Tribunal stated:

> The evidence establishes that Canada's policy was shaped to a very great extent by the desire and intent to protect and promote the market share of enterprises that would carry out the destruction of PCBs in Canada and that were owned by Canadian nationals. Other factors were considered, particularly at the bureaucratic level, but the protectionist intent of the lead minister in this matter was reflected in decision-making at every stage that led to the ban. Had that intent been absent, policy makers might have reached a conclusion in November 1995 that would have been consistent with the conclusion reached by Canada when the ban was lifted in February 1997.

S.D. Myers, ¶ 162. This evidence included the Lead Minister's statement that "it was the policy of the Canadian Government that PCB waste should be disposed 'in Canada by Canadians.'" *S.D. Myers* (separate opinion), ¶ 149; *see also id*. ¶¶ 169, 171 ("A statement by the lead Minister in the House of Commons with respect to government policy on an issue is ordinarily to be

accepted at face value as stating official government policy and the rationale behind it."). In fact, this promise by the Lead Minister to the Canadian operators was written down on a draft letter and later crossed out by hand "with the explanatory note . . . *I don't want to put the commitment down on paper.*" *S.D. Myers,* ¶ 174 (emphasis in original).

Methanex has alleged that California's MTBE ban was similarly motivated by protectionist intent. Indeed, Methanex's Amended Claim alleges that ADM routinely lobbied governmental officials against the use of methanol and MTBE by stridently characterizing them as "foreign" products, and that, as a result, numerous federal and state officials have publicly urged that "foreign" methanol and MTBE be replaced with home-grown ethanol to reduce America's dependence on foreign oxygenates. *See* Draft Am. Claim at 14-20. In fact, this protectionist intent is apparent on the face of Governor Davis's order. *See* Executive Order D-S-99 ¶ 11. Even the EPA itself, in seeking to favor ethanol over MTBE, expressed a blatantly protectionist intent:

> Money now spent on imported oil or oxygenates could instead be spent for renewable fuels made from feed stocks currently grown or processed in the United States. This would keep capital in the U.S., provide domestic jobs, strengthen our national security, and support a wide variety of American agricultural and fuel industries.

58 Fed. Reg. 68,343 at *3.

More specifically, Methanex has alleged, and it is certainly reasonable for the Tribunal to infer, that when ADM executives secretly met with Governor Davis, they repeated their usual protectionist arguments. Methanex has also alleged that ADM urged the MTBE ban in order to protect the U.S. ethanol industry. Finally, Methanex has alleged that Governor Davis acted at least in part on the basis of those arguments, and evidence of that protectionist intent appears in the Executive Order itself, which directs the California Energy Commission to foster the development of ethanol in California. *See* Draft Am. Claim at 47.

The evidence of protectionist intent is strengthened by the fact that State Senator Dick Mountjoy, one of the principal proponents of Senate Bill 521, has close ties to Oxybusters of California, an organization that is funded by and serves as a mouthpiece for ADM and the U.S. ethanol industry. *See* National Oxybuster Contact List; Sara Fritz and Dan Morain, *Stealth Lobby Drives Fuel Additive War*, L.A. Times, June 16, 1997, at A1 ("The probe recently yielded evidence allegedly demonstrating that Oxybusters receives financial support from Archer-Daniels-Midland").

The United States, however, contends that the MTBE ban could not have been motivated by discrimination because the U.S. methanol industry supplies three-quarters of U.S. methanol demand. *See* U.S. Reply Mem. at 19. That assertion ignores the fact that Methanex, a foreign methanol producer, supplied the vast majority of methanol *in California*. *Cf. California MTBE on Downturn*, Oxy-Fuel News, Apr. 9, 2001. Moreover, what actually motivated California is, of course, a disputed matter that cannot be assessed as a "jurisdictional" matter based on the pleadings. And regardless of whether the United States has a significant methanol industry, the domestic ethanol industry consistently portrayed methanol and MTBE as "foreign" products, and thus it is reasonable to infer that this image specifically influenced the Governor's decision to ban MTBE. *See* Draft Am. Claim at 13-20. Methanex thus has alleged a credible basis for concluding that California officials perceived methanol and MTBE as foreign products, and were improperly motivated by that perception, and by an intent to promote and protect the California and U.S. ethanol industries. For purposes of the U.S. motion to dismiss, Methanex need do no more.

Finally, the United States contends that the MTBE ban could not have been motivated by discriminatory intent because the Executive Order also directed the agencies to seek a waiver from EPA's oxygenate requirement. *See* U.S. Reply Mem. at 20-21, n.26. Again, the United

States invites factfinding that cannot properly be made at this stage of the case. Moreover, as discussed above, California requested the waiver only because of the physical and economical impossibility of immediately implementing the ban against MTBE. *See supra* pp. 7-8. California always understood the waiver to merely be a temporary stopgap measure that would in the long run benefit the domestic ethanol industry, and the Governor emphatically emphasized that even with the waiver "*a significant portion of California gasoline would still contain ethanol*." Cal. EPA, *Basis for Waiver*, at *7. Thus, the waiver request, rather than supporting the U.S. assertion, provides even more evidence of California's discriminatory intent.

c) California's Measures Had a Discriminatory Impact On Foreign Producers Of Methanol

California's MTBE ban also violates Article 1102 because it has the effect of favoring domestic investors and investments over foreign ones "in like circumstances." This *de facto* discrimination is well established both under Article 1102 itself, *see Pope & Talbot II*, ¶ 43 ("Article 1102 can apply to measures that do not facially discriminate against the investors or investments of other NAFTA parties"), and under the prior GATT jurisprudence on which Article 1102 was patterned, *see European Communities — Regime for the Importation, Sale and Distribution of Bananas* (Appellate Body) WT/DS27/AB/R, ¶ 234 (Sept. 9, 1997) ("we conclude that 'treatment no less favourable' . . . should be interpreted to include *de facto*, as well as *de jure*, discrimination"). "[I]f a measure is facially neutral, the question becomes whether behind that neutrality, the measure disadvantages the foreign owned investment." *Pope & Talbot II*, ¶ 56.

In determining whether a measure is discriminatory in effect, the critical issue is whether the measure has the *potential* to discriminate against the imported product. Prior GATT precedent makes this clear:

> In any event, the Panel doubted the feasibility of an approach that would require it to be demonstrated that differences between procedures under Section 337 and those in federal district courts had *actually* caused, in a given case or cases, less favorable treatment. The Panel therefore considered that, in order to establish whether the "no less favorable" treatment standard of Article III:4 is met, it had to assess whether or not Section 337 in itself *may* lead to the application to imported products of treatment less favourable than that accorded to products of United States origin. It noted that this approach is in accordance with previous practice of the CONTRACTING PARTIES in applying Article III, which has been to base their decisions on the distinctions made by the laws, regulations or requirements themselves and on their *potential* impact, rather than on the actual consequences for specific imported products.

United States Section 337 of the Tariff Act of 1930, BISD 36S/345, ¶ 5.13 (Nov. 7, 1989) (emphasis added); *see also European Community — Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins*, BISD 37S/86, ¶ 141 (1990) ("The Panel noted that the exposure of a particular imported product to a *risk* of discrimination constitutes, by itself, a form of discrimination.") (emphasis added); *Japan — Taxes on Alcoholic Beverages*, (Panel Report), WT/DS8/R ¶ 6.33 (July 11, 1996) ("it is not necessary to show an adverse effect on the level of imports, as Article III generally is aimed at providing imports with 'effective equality of opportunities' in 'conditions of competition.'").

California's MTBE ban violates Article 1102 because it creates a genuine risk of discriminating against foreign methanol producers by unjustifiably denying them access to the gasoline oxygenate sector and unjustifiably granting ethanol producers a windfall. The United States errs in contending that these impacts are not discriminatory because they apply to both foreign and domestic methanol producers. *See* U.S. Reply Mem. at 19. As explained above, it is irrelevant that domestic methanol producers are equally damaged by the MTBE ban. Under Article 1102, Methanex and its U.S. investments are entitled to the "most favorable treatment" accorded to domestic producers "in like circumstances." Because Methanex and its investments

are "in like circumstances" with U.S. ethanol producers, they are entitled to treatment as favorable as that received by U.S. *ethanol* producers, not simply treatment as favorable as that received by U.S. *methanol* producers. Because the ban accorded domestic ethanol producers better treatment than foreign methanol producers in like circumstances, it was discriminatory *de facto* as well as *de jure*.

3. The California Ban Was Not Necessary to Protect the Environment

NAFTA on its face contains no exception to the national treatment obligation set forth in Article 1102. While Article 1114 permits states to ensure that "investment activity in its territory is undertaken in a manner sensitive to environmental concerns," it requires such measures to be "otherwise consistent" with Chapter 11. Because California's MTBE ban was inconsistent with the national treatment requirement, Article 1114 cannot justify the discriminatory measures here. Nor can the United States rely on the General Exceptions provision in Article 2101, which is not applicable to Chapter Eleven.

In contrast to NAFTA, Article XX of GATT explicitly contains exceptions for health and environmental measures that violate national treatment. It states in part:

> Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures: . . . (b) *necessary* to protect human, animal or plant life or health . . . .

found in, Law & Practice of the World Trade Organization, Booklet 7 at 36 (Joseph Dennin ed. 1995) (emphasis added). Interpreting Article XX, GATT/WTO precedents have held that in order for a measure to be "necessary," it must be the least restrictive measure available to achieve that objective. *See Section 337*, ¶ 5.26 ("a contracting party cannot justify a measure inconsistent with another GATT provision as 'necessary' in terms of Article XX(d) if an

alternative measure which it could reasonably be expected to employ and which is not inconsistent with other GATT provisions available to it."); *Thailand - Restrictions on Importation of and Internal Taxes on Cigarettes*, BISD 37S/200, ¶ 75 (Nov. 7, 1990) ("the import restrictions imposed by Thailand could be considered to be 'necessary' in terms of Article XX(b) only if there were no alternative measures consistent with the General Agreement, or less consistent with it, which Thailand could reasonably be expected to employ to achieve its health policy objectives."). The failure of Chapter 11 to incorporate this exception could be taken as an indication that no such exception exists here.

However, other NAFTA tribunals have incorporated GATT's necessity exception into Chapter 11, and Methanex has no objection to such incorporation of important principle of international trade law. "Article 1102 (National Treatment) of NAFTA is not made subject to an equivalent of Article XX (General Exceptions) of GATT. *Read in its proper context, however, the phrase 'like circumstances' in Article 1102 in many cases does require the same kind of analysis as is required in Article XX cases under the GATT*." *S.D. Myers* (separate opinion), ¶ 129 (emphasis in original); *see also Cross-Border Trucking*, ¶ 258 ("the Panel is of the view that the proper interpretation of Article 1202 requires that differential treatment should be no greater than necessary for legitimate regulatory reasons such as safety.") Under these decisions, if the United States could prove that the MTBE ban was necessary to protect the environment,[11] and if it could show that the ban resulted in the least possible restriction on foreign investors and their investments, then the ban would not violate NAFTA. These factual issues, however, go squarely

[11] Governor Davis' Order identifies the environment, not health, as the basis for the ban. *See* Draft Am. Claim at 31. Thus, the U.S. will have to show that the ban is necessary to protect the environment. To date, the U.S. has offered no factual response to Methanex's contention that the environment could be protected by directly addressing the problem of leaking underground storage tanks.

to the merits of the case. As Methanex has alleged all the elements of a national treatment claim, this Tribunal has jurisdiction to hear the claim.[12]

C. The California Ban Violated Article 1105

In its prior submissions, Methanex demonstrated that Article 1105 of NAFTA, which by its terms incorporates "international law, including fair and equitable treatment and full protection and security," adopts fairness requirements and affirmative duties of care exceeding those imposed by the minimum standard of customary international law. *See* Methanex Counter-Mem. at 8-11. Methanex further demonstrated that, in any event, customary international law has long required states to behave fairly, reasonably, and in good faith. *See id.* at 12-13; Draft Am. Claim at 53-57. Methanex also demonstrated that these general equitable principles prohibit state discrimination on the basis of national origin, require transparent state action by a disinterested decisionmaker, and prohibit state action that restricts foreign investments needlessly and without justification. *See id.* at 49-53, 57-65. Finally, Methanex alleged that California's ban on MTBE violated all of these equitable principles, as well as the affirmative obligation of California (and the United States) to afford "full protection and security" to Methanex and its United States investments. *See id.* at 48-65; Statement of Claim at 11.

In response, the United States urges this Tribunal to impose on Article 1105 a remarkable series of textually unsupported restrictions. Despite the breadth of Article 1105's reference to "international law, including fair and equitable treatment and full protection and security," the

[12] Methanex already has made a credible allegation that the ban was entirely unnecessary. *See*, *e.g.*, Draft Am. Claim at 33-35. California has itself published evidence confirming that the ban was unnecessary: in 2000, MTBE was detected in less than two-tenths of one percent of California's water sources at a level above the aesthetic threshold. *See* Cal. Dep't of Health Services website *at* http:\\www.dhs.ca.gov/ps/ddwem/chemicals/MTBE/mtbeindex.htm. Accordingly, any "necessity" defense cannot possibly be resolved against Methanex at this stage of the case.

United States contends that this phrase does nothing more than incorporate the *minimum* protections of *customary* international law. *See* U.S. Mem. at 39-43; U.S. Reply Mem. at 23-27. It further contends that customary international law imposes *no* overarching duty for states to act fairly, reasonably, and in good faith (*see id.* at 27-30) and *no* overarching duty for states to afford "full protection and security" (*see* U.S. Reply Mem. at 36-39). Indeed, it specifically contends that Article 1105 imposes *no* procedural restrictions on legislative, executive, or administrative action (*see* U.S. Mem. at 44-45; U.S. Reply Mem. at 35-36), *no* substantive restrictions on measures that needlessly restrict foreign investments (*see id.* at 30-33), and *no* restrictions at all on discrimination against foreign investors and their investments (*see id.* at 33-35). Accordingly, the United States contends that Article 1105 does nothing more than prohibit the same uncompensated expropriations independently barred under Article 1110 (*see* U.S. Mem. at 46). Under that construction, it argues that Methanex has failed to state a claim.

In effect, the United States and the other NAFTA signatories would change Article 1105 to read as follows:

> Article 1105: *The International* Minimum Standard of Treatment *Is the Only Protection Accorded to NAFTA Investors*
>
> 1. Each party shall accord to investments of investors of another Party treatment *only* in accordance with *customary* international law, [including] *which does not include any requirement of* fair and equitable treatment [and] *nor any requirement of* full protection and security, *nor any requirement of non-discrimination.*

The mere recitation of the proposed changes shows that so drastic a change would, in fact, substantially amend NAFTA, not merely "interpret" it. Moreover, none of the proposed amendments has any legal or factual justification.

First, the "international minimum standard" has nothing to do with Article 1105. The ordinary meaning of the *heading* of Article 1105 is that the provision imposes a specific

"Minimum Standard of Treatment" on the NAFTA Parties. *See* Jennings Expert Report at 4. Thus, the text of Article 1105 defines the minimum standard of treatment that *this* treaty requires *these* Parties to accord *these* investments. The heading does not include the word "international," and there is no reason whatever to conclude that, instead of defining a treaty-specific standard, Article 1105 was somehow intended to incorporate the "international minimum standard." Indeed, the term "international minimum standard" appears *nowhere* in the text or history of NAFTA.

Second, Article 1105 nowhere even mentions "customary international law"; rather, it incorporates "*international law*, including fair and equitable treatment" (emphasis added). The same is true throughout NAFTA: Article 1131 provides for resolution of disputes in accordance with NAFTA "and applicable rules of *international law*" (emphasis added), and Article 102(2) provides for NAFTA to be applied "in accordance with applicable rules of *international law*" (emphasis added). These repeated and consistent references to "international law" are significant, because the terms "international law" and "customary international law" have settled and distinct meanings. Article 38 of the Statute of the International Court of Justice defines "international law" as:

> (a) international conventions, whether general or particular, establishing rules expressly recognized by the contesting States;
>
> (b) international custom, as evidence of a general practice accepted as law;
>
> (c) the general principles of law recognized by civilized nations;
>
> (d) subject to the provisions of Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law.

Other leading sources agree:

> (1) A rule of international law is one that has been accepted as such by the international community of states

(a) in the form of customary law;

(b) by international agreement; or

(c) by derivation from general principles common to the major legal systems of the world.

Restatement (Third) of Foreign Relations Law, § 102; *accord, e.g.*, T. Franck, *Fairness in International Law & Institutions* 448 (1995) (noting ICJ distinction between "customary and conventional (i.e., the law of multilateral conventions) international law").

Mexico has in past NAFTA proceedings explicitly accepted that Article 1105 goes beyond customary international law. It argued that Article 1105's drafters intended "to incorporate the public international law meaning of both "fair and equitable treatment" and "full protection and security" *Azinian v. Mexico*, Case No. ARB (AF)/97/2, Mex. Counter-Mem. ¶¶ 251, 258; *Mexico v. Metalclad, Inc.*, Case No. ARB(AF)/97/1, Mex. Counter-Mem. ¶¶ 837, 872; and it concluded that "public international law" distinguishes between but includes both "'customary' international law and treaty or 'conventional' international law." *Metalclad*, Mex. Outline of Argument ¶ 238. Given this settled distinction, and Mexico's past agreement, the United States provides no justification for construing an unqualified reference to "international law" as somehow referring only to "customary" international law.

Third, regardless of the precise scope of "international law" in Article 1105, the Parties expressly agreed when they signed NAFTA that this version of "international law" includes a requirement of "fair and equitable treatment and full protection and security," and they expressly agreed to provide such treatment, protection, and security to covered investments. It is axiomatic that treaty language controls over customary international law. "A subsequent agreement will prevail over prior custom." *Restatement* § 102, Reporter's Note 4.

Not surprisingly, given this historic context and NAFTA's express language, the United States can cite no authority for its remarkably parsimonious construction of Article 1105. Indeed, NAFTA tribunals have rejected that construction unanimously. *See, e.g.*, *Metalclad Corp. v. Mexico*, ICSID Case No. ARB (AF)/97/1 (Award of Aug. 30, 2000), ¶¶ 97, 99-101 (Article 1105 requires investor to be "treated fairly and justly"); *S.D. Myers* ¶¶ 134, 263 (similar); *Pope & Talbot II*, ¶ 111 (similar). Accordingly, the United States is reduced to arguing that *Metalclad* was "wrongly reasoned" (U.S. Mem. at 43), that *Pope & Talbot* was "poorly reasoned and unpersuasive" (U.S. Reply Mem. at 26), that the *S.D. Myers* majority set forth only "vague *dicta*" (*id*. at 29), and that the *S.D. Myers* concurrence was "unsupported musing" (*id*. at 30).[13] For the reasons explained herein and in Methanex's prior submissions, these cases were rightly decided, and the Tribunal should reject the United States' invitation to depart from the unambiguous text of Article 1105 and the unanimous judgment of three independent NAFTA tribunals.

1. Under the Plain Meaning of Article 1105, the United States Must Provide Fair and Equitable Treatment

Article 1105 expressly requires Parties to accord "fair and equitable treatment" to covered investments. In the face of such express treaty language, Methanex submits that this Tribunal's role is, simply, to determine if the United States treated Methanex and its U.S. investments fairly and equitably, regardless of any other precepts of international law.

Past NAFTA tribunals have applied this "plain meaning" standard. For example, the *Pope & Talbot II* tribunal concluded that "[i]nvestors are entitled to [fair and equitable treatment

[13] Equally absurd is the United States' assertion (U.S. Mem. at 46) that Article 1105's incorporation of "international law, including fair and equitable treatment and full protection and security" is in reality a disguised prohibition against uncompensated expropriation. That

and full protection and security] no matter what else their entitlement under international law." *Id.* ¶ 111. Similarly, the *Metalclad* Tribunal applied Article 1105 by reference to a straightforward inquiry into whether the investor was "treated fairly or equitably," without reference to any possible violations of customary international law. *Metalclad*, Award ¶¶ 97, 99-101.

Indeed, even Mexico has in the past urged NAFTA tribunals to apply the plain meaning of the terms of Article 1105. In *Azinian*, Mexico argued that because the phrase "fair and equitable treatment" was undefined in NAFTA, "Article 31 of the Vienna Convention" required that the phrase simply "be interpreted in good faith in accordance with [its] ordinary meaning, in [its] context, and in the light of [its] object and purpose." *Azinian*, Mex. Counter-Mem. ¶¶ 248, 257; *Metalclad*, Mex. Counter-Mem. ¶¶ 835, 871. According to Mexico, "[t]he ordinary meaning of the word 'fair' is 'just, unbiased, equitable; in accordance with the rules' and the ordinary meaning of the word 'equitable' is 'fair and just.'" *Azinian*, Mex. Counter-Mem. ¶ 250 (citing *The Concise Oxford Dictionary of Current English* (8th ed.)); *Metalclad*, Mex. Counter-Mem. ¶ 836 (citing same). And after setting out the ordinary meaning of the phrase, Mexico concluded that: "The fair and equitable treatment standard requires the Respondent to act in good faith, reasonably, without abuse, arbitrariness or discrimination." *Metalclad*, Mex. Counter Mem. ¶ 841; *see also Azinian*, Counter Mem. ¶ 251.

Commentators have also urged that "fair and equitable" be given its plain meaning:

> Following Mann, where the fair and equitable standard is invoked, the central issue remains simply whether the actions in question are

(continued…)

construction not only is textually unsustainable, but also would make Articles 1105 and 1110 needlessly and unjustifiably duplicative.

> in all the circumstances fair and equitable or unfair and inequitable.
>
> * * *
>
> The fair and equitable standard [allows] the parties to invoke considerations of reasonableness, fairness and equity in the circumstances, even if legal rules, strictly applied, may lead to a different approach.

Stephen Vasciannie, The Fair and Equitable Treatment Standard in International Investment Law and Practice, 1999 Brit. Y.B. 144 (1999).

> Still with reference to plain meaning, however, if there is discrimination on arbitrary grounds, or if the investment has been subject to arbitrary or capricious treatment by the host State, then the fair and equitable standard has been violated. This follows from the idea that fair and equitable treatment inherently precludes arbitrary and capricious actions against investors.

Id. at 133.[14]

Methanex has alleged that, taking into account all the facts and circumstances surrounding the MTBE ban, California acted unfairly and inequitably. Methanex is confident that it will ultimately prove that contention, but it would, in any case, be inappropriate to determine so fact-bound a contention at the jurisdictional stage.

2. The "Fair and Equitable Treatment" Requirement Exceeds the Minimum Requirements of "Customary" International Law

In its Counter-Memorial (at 8-11), Methanex demonstrated that the text of Article 1105, the decisions construing that provision, and the longstanding U.S. position in the *ELSI* case, *Elettronica Sicula, S.p.A.* (U.S. v. Italy), 1989 I.C.J. 15, case all establish that the requirement of

[14] Although the United States observes that academic writings "cannot create international law," it concedes that these sources have interpretive significance as "subsidiary means for the determination of rules of law." Statute of Int'l Ct. of Justice art. 38(1)(d); *see also* Moore, *Digest of International Law* 4 (1906) (works of commentators "are resorted to by judicial tribunals, not for the speculation of their author concerning what the law ought to be, but for trustworthy evidence of what the law really is").

"fair and equitable treatment," as expressly incorporated into Article 1105, exceeds the minimum requirements of "customary" international law.

Subsequently, the *Pope & Talbot* Tribunal provided further confirmation that the "fair and equitable treatment" requirement imposes duties beyond those required by the minimum standard of customary international law. Specifically, the Tribunal concluded that, under Article 1105, investors "are entitled to the international law minimum, *plus* the fairness elements" of fair and equitable treatment and full protection and security. *Pope & Talbot II*, ¶ 110. Furthermore, the Tribunal construed the "fair and equitable treatment" standard by reference to its settled meaning in the BITs. The Tribunal reasoned:

> It is true that the language of Article 1105 suggests otherwise, since it states that the fairness elements are included within international law. But that interpretation is clouded by the fact, as all parties agree, that the language of Article 1105 grew out of the provisions of bilateral commercial treaties negotiated by the United States and other industrialized countries.

Id. (footnotes omitted); *see also S.D. Myers* (separate opinion), ¶¶ 58-59 ("It seems obvious that the framers of NAFTA, in incorporating standard phrases from BITS, intended that they would have their standard meaning, or something very close to it.") (footnote omitted).

Intervening in *Pope & Talbot,* the United States argued as it does here that Article 1105 "'excluded any possible conclusion that the parties were diverging from the customary international law concept of fair and equitable treatment.'" *Pope & Talbot II*, ¶ 114 (quoting U.S. Fourth Submission ¶ 7). In support of its interpretation, the United States argued that the "fair and equitable treatment" standard arose out of the OECD Draft Convention on the Protection of Foreign Property, which was proposed in 1963 and revised in 1967. *Id*. ¶ 112. The *Pope & Talbot* Tribunal rejected the United States' assertions because "the question how to interpret the fairness elements where, as in the BITs and NAFTA, both concepts ['fair and

equitable treatment' and 'international law'] are expressly included, was not an issue before the drafters of the OECD Draft." *Id*. The Tribunal also concluded that the object and purpose of NAFTA, as well as the practical application of NAFTA undercut the interpretation urged by the United States. The Tribunal stated:

> Indeed, notwithstanding the position espoused by the United States, there are very strong reasons for interpreting the language of Article 1105 consistently with the language of the BITs. First, there is the basic unlikelihood that the Parties to NAFTA would have intended to curb the scope of Article 1105 *vis a vis* one another when they (at least Canada and the United States) had granted broader rights to other countries that cannot be considered to share the close relationships with the NAFTA parties that those Parties share with one another . . . . Article 103(2) expressly provides that, in the event of a conflict, NAFTA prevails over GATT and "other agreements to which [the NAFTA] Parties are party." Thus, on general principles of interpretation, it would be difficult to ascribe to the NAFTA Parties an intent to provide each other's investments more limited protections than those granted to other countries not involved jointly in a continent-wide endeavor aimed, among other things, at "increas[ing] substantially investment opportunities in the territories of the Parties." The Tribunal views these factors to be relevant to the interpretation of NAFTA as describing its "context, object, and purpose." Those factors are, of course, pertinent to definition of the "ordinary meaning" of Article 1105, and Article 102(2) of NAFTA itself requires the Parties "to interpret and apply the provisions of this Agreement in the light of the objectives set out in paragraph 1" thereof, which include "increas[ing] substantially investment opportunities."
>
> * * * *
>
> In addition to the context, object, and purpose of NAFTA, there is a practical reason for adopting the additive interpretation to Article 1105. As noted, the contrary view of that provision would provide NAFTA investors a more limited right to object to laws, regulation, and administration than accorded to host country investors and investments as well as those from countries that have concluded BITs with a NAFTA party. This state of affairs would surely run afoul of Articles 1102 and 1103, which give every NAFTA investor and investment the right to national and most favoured nation treatment.

Id. ¶¶ 115, 117 (footnotes omitted). That reasoning is sound, and this Tribunal should adopt it.

The United States further errs in attempting to distinguish the *ELSI* case based on the specific treaty language at issue there. *See* U.S. Reply Mem. at 25-26. The treaty at issue prohibited "arbitrary" measures. As Methanex has explained, the United States urged a literal construction of this term by reference to general notions of fairness, not a restricted construction based on the minimum standards of customary international law. *See, e.g.*, I.C.J., *Pleadings, Oral Arguments, Documents, Case Concerning Elettronica Sicula, S.P.A. (ELSI) (U.S. v. Italy)*, Vol. I at 76-77 ("'Arbitrary actions' include those which are not based on fair and adequate reasons (including sufficient legal justification), but rather arise from the unreasonable or capricious exercise of authority.") (footnote omitted). If those principles govern construction of a prohibition against "arbitrary" state action, then, *a fortiori*, they must also govern construction of an even broader obligation to afford "fair and equitable treatment."

The most extensive expert analysis of the relationship between the two standards squarely concludes that they are separate:

> The two standards in question are not identical: both standards may overlap significantly with respect to issues such as arbitrary treatment, discrimination and unreasonableness, but the presence of a provision assuring fair and equitable treatment in an investment instrument does not automatically incorporate the international minimum standard for foreign investors.

Vasciannie, *supra* at 144.

Indeed, Mexico has twice in the past taken precisely the same position as the *Pope & Talbot* tribunal and Methanex. In *Azinian* and *Metalclad*, Mexico maintained that the treatment prescribed by Article 1105 "can be divided into two express components, fair and equitable treatment and full protection and security, and one residual component, other standards of treatment mandated by international law." *Azinian*, Mex. Counter-Mem. ¶ 247; *see also*

Metalclad, Mex. Counter-Mem. ¶ 833 (stating same). Methanex fully agrees with Mexico's prior position.

Thus, the United States errs in contending that its litigating position in this case, which is now joined by Canada and Mexico, constitutes a "subsequent practice" that must be considered in construing Article 1105. *See* U.S. Reply Mem. at 23-25. To begin with, although the Vienna Convention does provide for consideration of "any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation," (art. 31(3)(b)), the United States provides no support for its remarkable assertion that a mere litigating position can constitute such a "subsequent practice."

"Subsequent practices" are a relevant interpretative aid only to the extent they provide "objective evidence" of how the parties interpreted the treaty *at the time it was concluded*. *See* György Haraszti, *Some Fundamental Problems of the Law of Treaties* 143 (1973). Self-serving arguments proffered by a party after a dispute has arisen, and particularly after that dispute has been submitted to an international tribunal, hardly provide this necessary element of objectivity. *See, e.g.,* Lord McNair, *The Law of Treaties* 428 (1986) (subsequent practices are an "extraneous aid for the interpretation of a treaty" when they occur "'at any time *before* the controversy arose.'") (emphasis added) (quoting from *The Franciska*, (1885) Spinks' Ecc. and Ad. Cases, 113, 150); Cheng, *General Principles of Law at* 309-10 ("Even where absolute sincerity and good faith are not in doubt, the statement of the facts in the pleadings by one of the interested parties, being a partial statement drawn up specially to present the case in the best possible light, cannot be considered as evidence and regarded as conclusive.") (footnote omitted).[15]

[15] S*ee also* 1 Oppenheim, *supra* § 554(11) (cited in U.S. Reply Mem. at 21, n.27) ("If the meaning of a provision is ambiguous, and one of the contracting parties, *at a time before a case arises for the application of the provision*, makes known what meaning it attributes to it, the

For these reasons, international tribunals use subsequent practices to *test* a party's litigating positions, not vice versa. For example, the *Beagle Channel* court rejected Argentina's construction of the border treaty at issue because its "conduct in the post-Treaty months" was "simply . . . not consistent with the interpretation of the Islands clause of the Treaty which Argentina" asserted during arbitration. *Beagle Channel Arbitration* (Arg. v. Chile), 52 I.L.R. 93 ¶ 129 (1977). In contrast, the court noted that Chile's conduct justified its position at arbitration "not because Chile could by her own acts confer upon herself rights or territorial attributions not provided for by the Treaty, but simply because these acts were consistent with, and bear out, the interpretation . . . which Chile now, *and then*, puts forward as being the correct one." *Id.* (emphasis original).[16] Thus, the United States has it exactly backwards in contending that a party's mere litigation position demonstrates the validity of the very practice being litigated.

In any event, the United States has failed to demonstrate the existence of a "subsequent practice." It is well-settled that "[t]he value and significance of subsequent practice will naturally depend on the extent to which it is concordant, common *and consistent*." *See* Sir Ian

(continued…)

other party or parties cannot, when a case for its application does occur, insist upon a different meaning unless it has previously protested . . .") (emphasis added).

[16] *See also Case Concerning Military and Paramilitary Activities in and Against Nicaragua* (Nicar. v. U.S.), 1984 I.C.J. 392, 408-10 (rejecting United States' argument that Nicaragua's consent to compulsory jurisdiction of the court was ineffective where the U.S.' own prior conduct demonstrated that the United States had believed the consent was effective); *Air Transport Services Agreement Case* (U.S. v. Italy), 16 R.I.A.A. 75, 84 (1965) (rejecting Italy's argument that bilateral aviation treaty did not cover "all-cargo" flights when its own unquestioned provision of all-cargo service to U.S. destinations provided evidence to the contrary); *International Status of South-West Africa*, 1950 I.C.J. 127 (rejecting South Africa's argument that its obligations under a mandate issued by the League of Nations ceased with the dissolution of that organization, where South Africa had repeatedly acknowledged the continuing effect of its obligations under the mandate after the League had dissolved).

Sinclair, *The Vienna Convention on the Law of Treaties* 137 (1984) (emphasis added). Yet the Parties' respective positions on Article 1105 have been anything but consistent.

For instance, until recently Mexico accepted that "fair and equitable treatment and full protection and security" were different standards of treatment than those mandated by international law. *See Azinian*, Mex. Counter-Mem. ¶ 247; *Metalclad*, Mex. Counter-Mem. ¶ 833. It also accepted that the fair and equitable standard should be applied by giving those words their ordinary meaning. *See Azinian*, Mex. Counter-Mem. ¶¶ 248, 257; *Metalclad*, Mex. Counter-Mem. ¶¶ 835, 871.

Canada's early construction of Article 1105 is similarly inconsistent with its current position. In the *S.D. Myers* arbitration, Canada's Statement of Defense never mentioned the word "customary" when discussing Article 1105. To the contrary, it observed that "Article 1105 provides that each Party shall accord to investments of investors of another Party treatment in accordance with *international law*, including fair and equitable treatment and full protection and security." *S.D. Myers*, Statement of Defence ¶ 44 (emphasis added). And, like Mexico in *Metalclad* and *Azinian*, Canada maintained that it had provided fair and equitable treatment because the measure in question:

> was properly made *in good faith* under section 35(1) of CEPA and in accordance with the regulatory process in Canada. All domestic legislative requirements were met. Myers does not allege that those requirements were themselves inadequate.

Id. ¶ 46 (emphasis added). Thus, the Parties' many past admissions clearly contradict the United States' current assertion that Article 1105 provides very limited protections.

Finally, and most fundamentally, the United States' "subsequent practice" argument ignores the basic distinction between interpretation and amendment. In contending that Article 1105 incorporates only "customary" international law (despite the explicit textual reference to

"international law"), and thereby excludes requirements of "fair and equitable treatment" and "full protection and security" (despite the explicit textual incorporation of those standards), the United States seeks not to construe Article 1105, but, retroactively, to amend it. Such amendments can be accomplished only under the formal procedures specified in NAFTA Article 2202, not by blind deference to an *ad hoc* set of unsupported litigating positions. Indeed, the Vienna Convention itself makes clear that "subsequent practices" are relevant only to help construe existing treaty provisions (*see* article 31(3)(b)) and cannot themselves effect a treaty amendment.[17]

3. In Any Event, Customary International Law Includes Equitable Principles of Fairness, Good Faith, and Reasonableness

In its prior submissions, Methanex cited a wide range of international decisions, treaties, and secondary sources demonstrating widespread international acceptance of the principle that states must act with fairness, good faith and reasonableness towards foreign nationals and their investments. *See* Counter-Mem. at 12-13; Draft Am. Claim at 53-56. Considered together, these sources establish a "practice" (*Restatement*, *supra* § 101, cmt. d) sufficiently widespread and

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[17] As originally drafted by the International Law Commission (ILC), proposed Article 38 of the Vienna Convention provided that: "A treaty may be modified by subsequent practice in the application of the treaty establishing the agreement of the parties to modify it[] . . . ." S. P. Jagota, "Vienna Convention on the Law of Treaties, 1969," *in Essays on the Law of Treaties* 187 (Agrawala, ed. 1972). But the U.N. Conference convened to consider the ILC draft ultimately deleted the proposed Article 38— the only provision in the entire ILC draft that the Conference deleted. *See id. The United States itself favored deletion of proposed Article 38 out of concern that "an agreement might be deemed amended as a result of unauthorized actions by low-ranking officials." Restatement* § 334 Reporters' Note 2 (emphasis added). A majority of the Conference agreed, and proposed Article 38 was deleted to ensure

> that the modification of treaties by subsequent practice, if it established the agreement of the parties, must be recorded in writing and therefore the treaty must be modified by a formal amendment, whether embodied in a protocol, an exchange of letters, or in some more formal document.

Jagota at 187-88.

longstanding to be fairly included even within "customary" international law. Indeed, even in the absence of controlling treaty provisions or judicial decisions, the International Court of Justice routinely consults both "international custom" and "the general principles of law recognized by civilized nations." Statute of ICJ art. 38(1) (*supra* at p. 34); *see also* Jennings Expert Report at 1.

In response, the United States does not offer a single case, treaty, or secondary source either affirmatively rejecting the basic equitable principles or contending that they are not widely established. Instead, it attempts (unsuccessfully) to distinguish some individual authorities on their facts, and it contends (incorrectly) that other individual authorities are wrongly decided. *See* U.S. Reply Mem. at 27-29. In its own affirmative case, the United States relies exclusively on the naked assertion, unencumbered by any meaningful analysis, that its expert is "aware of no rule of customary international law that imposes a *general* obligation of good faith and reasonableness on States." Vagts' Reply Report ¶ 6. But, as explained below and by Sir Robert Jennings, and as confirmed by Sir Ian Sinclair, "there is considerable authority for the view that good faith [and reasonableness] is a general principle of customary law." Jennings' Expert Report at 1; *see also* Sinclair Statement. Even the United States itself has long endorsed the position that "principles of international law, recognize that where the means employed do not fit the expressed goal, or are legally impermissible, then those means are *arbitrary and unreasonable*." *ELSI*, Vol. II, at 385 (Reply of the U.S.) (emphasis added).

The United States errs in asserting that existing international case law merely applies the obligation of good faith and reasonableness to the performance of existing treaty obligations. A recent decision by the appellate body of the WTO spectacularly rebuts that contention. In *United States — Tax Treatment for "Foreign Sales Corporations,"* WT/DS108/AB/R (Feb. 24, 2000), that body held explicitly that a treaty codification of a "good faith" requirement was merely a

"specific manifestation of the principle of good faith which, we have pointed out, is at once a general principle of law and a principle of general international law." *Id.* ¶ 166. Moreover, it further described "the principle of good faith" as follows:

> This principle, at once a *general* principle of law and a *general* principle of international law, controls the exercise of rights by states. One application of this general principle, the application widely known as the doctrine of *abus de droit*, prohibits the abusive exercise of a state's rights and enjoins that whenever the assertion of a right "impinges on the field covered by [a] treaty obligation, it must be exercised bona fide, that is to say, reasonably."

United States - Import Prohibition of Certain Shrimp and Shrimp Products, WT/DS58/AB/R, ¶ 158 (Oct. 12, 1998) (emphasis added).[18]

Likewise, the United States gains nothing from its assertion that Methanex relies on numerous "treaty provisions that imposed an obligation of reasonableness on specified State activities." U.S. Reply Mem. at 28. Even apart from the simple and dispositive response that NAFTA itself is such a treaty, the widespread usage of such equitable obligations provides further confirmation that customary international law does include such principles. Indeed, the precise equitable standard at issue here — "fair and equitable treatment" — has been used in literally hundreds of bilateral investment treaties. *See*, *e.g.*, M. Khalil, *Treatment of Foreign*

[18] The United States errs in its specific characterization of the *Nuclear Tests* case as resting on the traditional concept of *pacta sunt servanda*. Contrary to the United States' characterization, that case specifically extended the requirement that parties perform treaty obligations in good faith to the context of unilateral acts. The tribunal reasoned: "One of the basic principles governing the creation and performance of legal obligations, *whatever their source*, is the principle of good faith. . . . Just as the very rule of pacta sunt servanda in the law of treaties is based on good faith, so also is the binding character of an international obligation assumed by unilateral declaration." *Nuclear Tests* (Austl. v. Fr.), 1974 I.C.J. 253 (Judgment of Dec. 20) ¶ 46 (emphasis added); *see also Korea - Measures Affecting Government Procurement*, WT/DS163/R, ¶ 7.102 (May 1, 2000) (extending the good faith requirement beyond the "traditional approach represented by *pacta sunt servanda*" to parties' "obligation to *negotiate* in good faith") (emphasis added).

Investment in Bilateral Investment Treaties, Table C, 233, 237, *in* I. Shihata, *Legal Treatment of Foreign Investments, "The World Bank Guidelines"* (1993) (92% of all BITs contained a "fair and equitable treatment" provision); Rudolf Dolzer and Margrete Stevens, *Bilateral Investment Treaties* 58 (1995) ("Nearly all recent BITs require that investments and investors covered under the treaty receive 'fair and equitable treatment,' in spite of the fact that there is no general agreement on the precise meaning of this phrase.").[19]

With regard to secondary sources, the United States quibbles that the "abuse of rights" doctrine discussed by Sir Gerald Fitzmaurice, which provides that a state "must exercise its rights in good faith and with a sense of responsibility" (*see* Draft Am. Claim at 54) "has not been affirmed by the [ICJ]." U.S. Reply Mem. at 29-30. As noted above, however, that doctrine has been specifically affirmed by WTO appellate authority. *See Tax Treatment For "Foreign Sales Corps.," supra*, ¶ 158. Moreover, numerous other distinguished commentators have confirmed that the doctrine is enforced by international tribunals, including the ICJ. *See*, *e.g.*, Ian Brownlie, *Principles of International Law* 19 (1998) ("Examples of this type of general principle are the principles of consent, reciprocity, equality of states, finality of awards and settlements, the legal validity of agreements, *good faith*, domestic jurisdiction, and the freedom of the seas.") (emphasis added); *Oppenheim's International Law* 38 (Jennings and Watts eds. 1992) ("A principle which has . . . been invoked by the Court [the ICJ], and is of overriding importance, is that of *good faith.* . . . The significance of this principle touches *every aspect of international law*.") (emphasis added); *see also* Jennings Expert Report at 1-2.

[19] Indeed, the principle of "fair and equitable treatment" has been accepted in hundreds of bilateral investment treaties, as well as in many multinational treaties such as NAFTA, and the ASEAN Agreement for the Promotion and Protection for Investments, *see* Paul Davidson, *Trading Arrangements in the Pacific Rim: ASEAN and APEC*, Booklet I.B.12.a., at 3 (2001), and

Finally, the United States does not even attempt to distinguish the most directly relevant authority of all: the NAFTA decisions holding that Article 1105, consistent with its literal terms, "imports into NAFTA the international law requirements of due process, economic rights, obligations of good faith and natural justice." *S.D. Myers*, ¶ 134. Instead, it is left with its refrain that these decisions are "wrongly reasoned" (citing *Metalclad*) or "not persuasive" (citing *S.D. Myers*). U.S. Reply Mem. at 29. As explained above and in Methanex's prior submissions, however, these decisions are obviously correct and should be followed here.

4. Article 1105 Incorporates Various Fairness Principles Directly At Issue Here

In its prior submission, Methanex alleged that the California ban on MTBE failed to provide "fair and equitable treatment" for several reasons: because it was the product of discrimination against Canadian investors and their investments, because it resulted from an unfairly opaque process by a financially biased decisionmaker, and because it restricted investments needlessly and without justification. Draft Am. Claim at 49-65; Statement of Claim at 11. In response, the United States does not challenge Methanex's allegations in any of its factual particulars. Rather, it contends that the "fair and equitable treatment" requirement of Article 1105 (whether or not grounded in "customary" international law) incorporates *none* of these substantive, procedural, or anti-discrimination principles. Its contentions, however, cannot withstand scrutiny. *See* Daniel M. Price, *Investment, Sovereignty and Justice: Arbitration Under NAFTA Chapter Eleven*, 23 Hastings Int'l & Comp. L. Rev. 421, 423 (2000) (fair and equitable treatment is designed "to ensure a certain baseline level of protection that would

(continued…)
the ACP-EEC Convention (Lomé IV), *see International Legal Materials*, Vol. 29, 809, 864 (1990).

require governments to act fairly, in good faith, and transparently in their relations with foreign investors.").

a) Discrimination Is Actionable Under Article 1105

The United States does not dispute that discrimination against foreign investors and their investments is inherently unfair and inequitable. As international legal scholars have recognized "the concept [of fair and equitable treatment] connotes the principle of non-discrimination and proportionality in the treatment of foreign investors." P. Muchlinski, *Multinational Enterprises and the Law* § 2.31 (1995); *see also* Vasciannie, *supra* at 131. Thus, if a measure accords less favorable treatment to foreign investors and their investments, it violates Article 1105 as well as Article 1102. *See S.D. Myers*, ¶ 266 ("a majority of the Tribunal determines that on the facts of this particular case the breach of Article 1102 essentially establishes a breach of Article 1105 as well."). And Mexico has in past proceedings accepted that Article 1105 prohibits discrimination.

> The concept of fair and equitable treatment is not precisely defined. It offers a general point of departure in formulating an argument that the foreign investor has not been well treated by reason of discriminatory or other unfair measures being taken against its interests.

Metalclad, Mex. Outline of Argument ¶ 526 (quoting Muchlinski, *supra*).

Nonetheless, the United States contends that the structure of Chapter 11 evidences an intent to immunize discrimination from scrutiny under Article 1105. It relies primarily on Article 1108, which specifically authorizes particular kinds of discrimination. *See* U.S. Reply Mem. at 33-34. It may be that discrimination authorized by Article 1108 is immune from review under either Article 1102 or Article 1105. But Article 1108 by its terms applies only to limited categories of discrimination such as preexisting measures, government procurement, and subsidies. The United States does not and could not contend that it is applicable here.

Accordingly, Article 1108 affords no basis for precluding operation of Article 1105 in accordance with its terms.

b) Article 1105 Prohibits Biased Decisionmaking By Public Officials

As Methanex demonstrated in its Draft Amended Claim, Article 1105 incorporates the basic equitable principle, "common to all legal systems," that a "person sitting in a decision-making capacity must be independent and without a personal or pecuniary interest in the matter, so as to enable him to act in good faith." Draft Am. Claim at 49. Plainly, this principle applies to a public official receiving substantial private financial remuneration for a governmental act disadvantaging a competitor. Here, Methanex alleges that ADM used its financial contributions to induce the Governor of California to discriminate against foreign methanol investors. This allegation of unfair treatment falls squarely within the scope of Article 1105. *See* Jennings Expert Report at 6.

The United States contends that the principle of neutral government decisionmaking applies only to judicial officials. U.S. Reply Mem. at 35 n.49. The United States is wrong. In *Metropolitan Properties Ltd. (F.G.C.). v. Lannon* 1 Q.B. 577 (U.K. 1969), the court applied the requirement of neutral decisionmaking to the London Rent Assessment Panel, which does not act in a judicial capacity. Similarly, in *Webb v. Queen*, (1994) 181 C.L.R. 41, 53, the High Court of Australia made clear that the requirement of neutral decisionmaking likewise applies to "a commissioner determining an industrial dispute or a member of a statutory tribunal inquiring into conduct in an industry which it supervises."

The United States further relies upon Professor Vagts for the proposition that there is no "international consensus on the subject of the proper regulation of campaign finance." U.S. Reply Mem. at 35. Perhaps not, although we note that, despite the United States' suggestion to

the contrary, each of the Parties has enacted laws closely regulating the permissibility of campaign contributions. In any event, Professor Vagts's assertion is simply irrelevant to Methanex's far more pointed allegation that ADM, through significant financial contributions to the Governor of California, induced a discriminatory and unjustified ban on MTBE. If true, those allegations establish that Methanex did not receive "fair and equitable treatment" as those terms are used in Article 1105.

c) Article 1105 Requires A Transparent Decisionmaking Process

Methanex further alleges that the ban on MTBE was also unfair because that ADM, its principal competitor, enjoyed secret and unequal access to the relevant government decisionmakers. Draft Am. Claim at 21-24. In response, the United States errs in contending (U.S. Mem. at 44) that Article 1105 simply does not address transparency (or any other element of procedural fairness).[20]

By its terms, NAFTA itself makes clear that transparent government decisionmaking is an essential element of procedural fairness. Article 102, which applies to all of NAFTA, specifically identifies "transparency" as a rule or principle that is essential to achieving "[t]he objectives of this Agreement," including the objective to "increase substantially investment opportunities in the territories of the Parties." Article 1802 of NAFTA further specifically mandates notice and comment procedures for all government measures of "general application."

Moreover, transparency and procedural fairness are fundamental principles of international law, which are thus incorporated into Article 1105. *See* Price, *Investment,*

[20] Even Canada admits that NAFTA addresses transparency. *See* Canadian Statement on Implementation*, North American Free Trade Agreements, Treaties*, Vol. 2 Booklet 12A at 7 (1994) ("In effect, it provides the guiding principles for the interpretation of the Agreement as a whole. These principles — nondiscrimination, transparency, cooperation and due process — are then worked out in detail in the chapters that follow.")

Sovereignty and Justice, *supra* at 424. ("The fair and equitable treatment standard is closely aligned with, and overlaps, certain *fundamental principles of international law* — including *transparency, procedural fairness,* and the duty of good faith — from which other, more specific legal rules emanate.") (emphasis added); *see also United States - Shrimp*, ¶ 182 (reading into GATT Article XX the "fundamental requirement" of due process); *Maffezini v. Kingdom of Spain*, Case No. ARB/97/7 ¶ 83 (Nov. 13, 2000) (finding that the lack of transparency with regard to a loan transaction was incompatible with a BIT's fair and equitable treatment requirement).

Applying these provisions, at least two NAFTA tribunals have held that transparency is an essential element of fairness required by Article 1105. In *Metalclad,* the Tribunal found a violation of Article 1105 precisely because "Mexico failed to ensure a transparent and predictable framework for Metalclad's business planning and investment." *Metalclad*, ¶ 99. The Tribunal reasoned:

> Prominent in the statement of principles and rules that introduces the Agreement is the reference to "transparency" (NAFTA Article 102(1)). The Tribunal understands this to include the idea that all relevant requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made, under the Agreement should be capable of being readily known to all affected investors of another Party.

Id ¶ 76.[21]

[21] For several reasons, the decision of the Supreme Court of British Columbia partially overturning *Metalclad* is not persuasive. To begin with, the court erred in concluding that transparency is not an important procedural objective of NAFTA, as Articles 102 and 1802 make clear. Moreover, because transparency is an essential element of procedural fairness under international law in any event, as the *Import Prohibition* and *Maffezni* decisions make clear, it is encompassed within the requirement of "fair and equitable treatment" regardless. Finally, and most fundamentally, the municipal court reviewing *Metalclad* is not an international tribunal at all, and it plainly overstepped its authority in substituting its judgment on issues of international

Likewise, the concurrence in *S.D. Myers* found a violation of Article 1105 because "the Government of Canada did not act in a manner consistent with the principles of transparency and procedural fairness." *S.D. Myers* (separate opinion), ¶ 249. The concurrence reasoned:

> S.D. Myers was not just another interest affected by Canada's export ban. The Government of Canada imposed the ban in direct response to the success of S.D. Myers in obtaining approval from the EPA to import PCBs. The government's thinking was largely shaped by lobbying from two of S.D. Myers' potential competitors, whose main interest was to keep S.D. Myers in particular, and other U.S. competitors in general, out of the game. Lobbyists for these interests were given access to senior political and bureaucratic officials at the Department of the Environment, and were provided with assurances that the border would be closed. S.D. Myers was not alerted that a regulation was in the works and was not consulted. In fact, *the Government of Canada gave S.D. Myers' competitors preferred and privileged access to key decision-makers*, made no effort whatsoever to inform or consult S.D. Myers, and produced a ban that was intended to specifically minimize S.D. Myers' place in the market - and effectively did so for some time. The defects in how S.D. Myers was treated cannot be dismissed on the basis that S.D. Myers was just another party with a material interest in a regulatory or legislative change of broad effect. S.D. Myers was the principal cause of the ban and was the interest that was most harmed by it.

Id. ¶¶ 247-48 (emphasis added). Under that reasoning, Methanex's allegations here — that the MTBE ban was "shaped by lobbying" from its U.S. competitors; that those competitors received secret, preferred and privileged "access" to and "assurances" by the relevant decisionmaker; and that Methanex, the principal competitor harmed by the ban, received no such "access" or "assurances" — plainly state a claim under Article 1105.

(continued…)

law for that of the international arbitral tribunal assigned express adjudicatory authority pursuant to NAFTA.

d) Article 1105 Incorporates Widely-Accepted Principles of International Law Including WTO Principles

In its prior submissions, Methanex demonstrated that Article 1105 also incorporates the principle recognized in two widely-ratified multinational treaties (the WTO Technical Barriers Agreement and the WTO Sanitary Measures Agreement) that governmental measures cannot restrict trade any more than necessary to achieve a legitimate state objective. Draft Am. Claim at 58-65; *see also* Robert Stumberg, *Direct Investment: Sovereignty by Subtraction: The Multilateral Agreement on Investment*, 31 Cornell Int'l L.J. 491, 510, 562 n.498 (1998) (noting that a similar provision in the Multilateral Agreement on Investment would incorporate non-MAI international law standards). The United States offers no proper ground for excluding this principle from the "fair and equitable treatment" standard.

Initially, the United States errs in contending (U.S. Reply Mem. 30-31) that Article 1105 incorporates only "customary" international law, which does not include the least restrictive principle codified in the WTO agreements. As explained above, Article 1105 by its terms incorporates any principle of "international law," including its "customary" and treaty components, that define the meaning of "fair and equitable," or that is relevant to the protection of investments. Moreover, as explained in detail below, the least restrictive measure principle is a part of "customary" international law in any event.

Furthermore, the United States errs in arguing (U.S. Reply Mem. 31-32) that Articles 1116 and 1117 do not by their terms reach principles of international law incorporated in treaties. Nothing in those provisions precludes treaty principles from being incorporated into Article 1105. Rather, Articles 1116 and 1117 provide express rights of action for breaches of Article 1105, which itself requires "treatment in accordance with international law." Articles 1116 and

1117 thus reinforce Methanex's position that California's measures were not fair and equitable because less-restrictive alternative measures existed to address California's water problems.

Contrary to U.S. characterization, it is not "absurd" that NAFTA incorporates WTO principles. Rather, it is eminently reasonable that Article 1105 would incorporate principles of international law already recognized in other treaties. As the *Pope & Talbot* tribunal explained, due to "the special bonds of friendship and cooperation" among the NAFTA Parties, they intended to grant each other's investors and investments better treatment than those granted to other countries. *Pope & Talbot II*, ¶ 115. Indeed, incorporating such treaty provisions in NAFTA was necessary to ensure most-favored-nation treatment for the parties, as expressly required by NAFTA itself.[22] As *Pope & Talbot* recognized, giving NAFTA investors "a more limited right to object to laws, regulations and administration than accorded to host country investors and investments . . . would surely run afoul of Articles 1102 and 1103, which give every NAFTA investor and investment the right to national and most favoured nation treatment." *Id*. ¶ 117.[23]

In any event, the least-restrictive measure principle embodied in the WTO Agreements is widely followed among civilized nations, and thus constitutes a part of "customary" international

[22] Article 1103 guarantees NAFTA Parties most-favored-nation treatment. It states: "Each Party shall accord to investors [and their investments] of another Party treatment no less favorable than that it accords, in like circumstances, to investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments." Article 1103(1).

[23] Incorporating legal principles relevant to investment protection will not create a private right of action for any breach of any GATT, WTO, or other multilateral obligation. Regardless how fair and equitable is eventually defined, a Chapter 11 claimant must always meet the specified requirements, including that the measure complained of actually damaged a covered investment. In fact, incorporating relevant international law principles will serve to define the legitimate bounds of Chapter 11, *limiting* it to investment claims that are properly grounded in international law, and avoiding claims based only upon some subjective perception of unfairness.

law. Many international tribunals and scholars have recognized that treaty provisions, if widely adopted, can become a source of customary international law. *See* Jennings Expert Report at 4 ("the main engine of change [of customary international law] is international practice, particularly as evidenced by treaties both bilateral and multilateral."); *see also North Sea Continental Shelf* (F.R.G. v. Den.; F.R.G. v. Neth.), 1969 I.C.J. 3, ¶ 71; *Case Concerning the Continental Shelf* (Libya v. Malta), 1985 I.C.J. 13, ¶ 27; Green Haywood Hackworth, *Digest of International Law* 17, 19 (1940); Brownlie, *Principles of Public International Law* at 12. As the least-restrictive-measure principle was long accepted under the GATT,[24] and was explicitly adopted by more than one hundred states in the WTO Agreement, it has become a part of customary international law. *See* Terrence P. Stewart (ed.), *The World Trade Organization: The Multilateral Trade Framework for the 21st Century and U.S. Implementing Legislation* 1 (1996).

Indeed, NAFTA tribunals have rightly applied the least-restrictive-measure principle as a fundamental principle of international law. In *S.D. Myers*, for example, both the majority and the concurrence applied that principle in assessing a claim of discrimination under Article 1102. The *S.D. Myers* majority explained:

> Canada was concerned to ensure the economic strength of the Canadian industry, in part, because it wanted to maintain the ability to process PCBs within Canada in the future. This was a legitimate goal, consistent with the policy objectives of the Base1 Convention. There were a number of legitimate ways by which Canada could have achieved it, but preventing SDMI from

[24] For example, GATT precedents had held that in order for a measure to fall within one of the exceptions under Article XX there could be no alternative measure that was less trade-restrictive. *See Section 337*, ¶ 5.26 ("a contracting party cannot justify a measure inconsistent with another GATT provision as 'necessary' in terms of Article XX(d) if an alternative measure which it could reasonably be expected to employ and which is not inconsistent with other GATT provisions is available to it."); *Thailand - Cigarettes*, ¶ 75 ("the import restrictions imposed by Thailand could be considered to be 'necessary' in terms of Article XX(b) only if there were no alternative measures consistent with the General Agreement, or less inconsistent with it, which Thailand could reasonably be expected to employ to achieve its health policy objectives.").

> exporting PCBs for processing in the USA by the use of the Interim Order and the Final Order was not one of them. The indirect motive was understandable, but the method contravened Canada's international commitments under the NAFTA. Canada's right to source all government requirements and to grant subsidies to the Canadian industry are but two examples of legitimate alternative measures.

See S.D. Myers, ¶ 255. The *S.D. Myers* concurrence reasoned similarly:

> The determination of whether there is a denial of national treatment to investors or investments in "like circumstances" under Article 1102 of NAFTA may require an examination of whether a government treated non-nationals differently in order to achieve a legitimate policy objective that could not reasonably be accomplished by other means that are *less restrictive to open trade*.

S.D. Myers (separate opinion), ¶ 129 (emphasis added).

Likewise, the Tribunal in *Cross-Border Trucking* also applied the least-restrictive-measure principle to Article 1202, the national treatment provision for service providers:

> Also, if under the GATT/WTO jurisprudence a Party is "bound to use, among the measures reasonably available to it, that which entails the least degree of inconsistency with other . . . provisions," in this NAFTA case, the United States has failed to demonstrate that there are no *alternative means* of achieving U.S. safety goals that are more consistent with NAFTA requirements than the moratorium.

Cross-Border Trucking, ¶ 270 (emphasis added).

In sum, the least-restrictive measure principle is now widely accepted as a general norm of customary international law. For that reason, and because international law includes treaty law, it is incorporated into the "fair and equitable treatment" standard at Article 1105. Because Methanex has alleged that the MTBE ban was enacted despite the existence of less-restrictive alternative measures, it has sufficiently alleged a violation of Article 1105.

5. The United States Failed to Accord Full Protection and Security

In addition to breaching the "fair and equitable treatment" standard under Article 1105, the United States has also failed to accord Methanex "full protection and security." The plain

terms of Article 1105 require that NAFTA Parties accord foreign investors and their investments *both* "fair and equitable treatment *and* full protection and security" (emphasis added). As both the United States and California failed to exercise their affirmative duties to protect Methanex's investment in the U.S., Methanex has sufficiently alleged a violation of the "full protection and security" requirement.

The United States wrongly contends that the "full protection and security" requirement applies only to physical harms and criminal acts. Based on its reading of customary international law,[25] the United States argues that the full protection and security requirement is only applicable when the "State failed to provide a reasonable police protection against acts of a criminal nature that physically invaded the person or property of an alien." U.S. Reply Mem. at 37. However, this argument would unduly dilute the meaning of "full protection and security" beyond what can be supported by the ordinary meaning of "full."

The "full protection and security" requirement is not limited to criminal acts. The only NAFTA tribunal that has considered the issue has concluded that it has a much wider reach than is urged by the United States:

> Article 1105, in requiring a Party to provide "full protection and security" to investments of investors, must extend to the protection of foreign investors from private parties when they act through the judicial organs of the State.

The Loewen Group, Inc. v. United States (Decision on Jurisdiction), Case No. ARB(AF)/98/3, ¶ 58 (2001). Similarly, international tribunals that have interpreted the same language in the context of BITs have not limited the "full protection and security" requirement to criminal violations. Thus, the Tribunal in *American Manufacturing & Trading, Inc. v. Zaire*, 36 I.L.M.

1531 (1997) ("*AMT*"), emphasized the breadth of the affirmative duty and did not limit it to criminal actions. *See id.* ¶ 6.05 ("Zaire must show that it has taken *all* measure of precaution to protect the investments.") (emphasis added). Moreover, there is no reason to suspect that the "full protection and security" language in BITs was limited to criminal acts, as those treaties generally contained a more specific provision with regard to war or riots. *See id.* ¶ 6.12. Indeed, the *AMT* Tribunal noted that a state's domestic law was irrelevant to whether a BIT was violated: "It is of no or little consequence whether it be a member of the Zairian armed forces or any burglar whatsoever. This responsibility Zaire cannot set aside by invoking its own national legislation." *Id.* ¶ 6.13.

The "full protection and security" requirement is also not limited to physical harms. This is apparent in Article 1139 of NAFTA, which broadly defines investment to include "intangible" property. Because the NAFTA parties intended to protect intangible investments as well as tangible ones, they could not have intended to restrict protection to cases involving physical harm. Indeed, Mexico has in the past explicitly accepted a broad definition. In *Azinian* and *Metalclad*, Mexico argued that "full protection and security" imposes an obligation of "due diligence" which requires the state to "act[] reasonably in the protection of foreign investments;" *Azinian*, Counter-Mem. ¶ 260; *Metalclad*, Counter-Mem. ¶ 874.

Finally, the United States argues that Methanex urges an improper standard of strict liability. U.S. Reply Mem. at 38. That is incorrect. In its Draft Amended Claim, Methanex contends only that the "full protection and security" requirement imposes affirmative duties "to

(continued…)

[25] The United States' argument that "full protection and security" is explicitly subsumed by the minimum standard under customary international law must be rejected for the same reasons as the "fair and equitable treatment" language is not subsumed. *See supra* C. 1-2.

take *reasonable* steps" to protect covered investors and investments. Draft Amended Claim at 66 (emphasis added and citation omitted). Methanex is entitled to a hearing on its allegations that neither California nor the United States took such "reasonable" protective steps here.

D. The California Ban Expropriated Methanex's Investments

NAFTA Article 1110(1) states in relevant part that "[n]o Party may directly or indirectly nationalize or expropriate an *investment* of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an *investment* . . . except: (a) for a public purpose; (b) on a non-discriminatory basis; (c) in accordance with due process of law and Article 1105(1); and (d) on payment of compensation . . . ." (emphasis added). Methanex has validly alleged that the MTBE ban expropriated the goodwill, market access, and customer base of itself, and its U.S. enterprises (Methanex U.S. and Methanex Fortier). Methanex has further alleged that this expropriation violated Article 1110 because the MTBE ban was not enacted for a legitimate public purpose, because it unfairly discriminates against Methanex, because it violated Article 1105(1), and because Methanex has never received any compensation.

In response, the United States contends only that Methanex has failed to identify an Article 1110 "investment." Its arguments, however, are meritless.

1. NAFTA's Definition of Investment Includes Intangible Property Such As Goodwill and Market Access

Article 1139 of NAFTA broadly defines "investment" to include "(g) real estate or other property, tangible *or intangible*, acquired in the expectation or used for the purpose of economic benefit or other business purpose;" and "(h) interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such a territory" (emphasis added). By its terms, this definition encompasses goodwill and market access as intangible

property providing "economic benefit" to Methanex and "interests" arising from its decision to invest.

The structure of NAFTA confirms that the definition of "investment" generally includes "intangible" property and economic "interests." Article 1139(i) and (j) set forth very limited exclusions from the definition of "investment":

> . . . but investment does not mean,
> (i) claims to money that arise solely from
> (i) commercial contracts for the sale of goods or services by a national or enterprise in a territory of a Party to an enterprise in the territory of another Party, or
> (ii) the extension of credit in connection with a commercial transaction, such as trade financing, other than a loan covered by subparagraph (d); or
> (j) any other claims to money, that do not involve the kinds of interests set out in subparagraphs (a) through (h);

Article 1139 thus confirms that "[w]here parties wanted to carve something out, such as public debt, they did. The carve-out is there. Where they wanted to exclude receivables or other interests arriving merely from the cross-border sale of goods, they did." Daniel M. Price, *Chapter 11 - Private Party vs. Governments, Investor-State Dispute Settlement: Frankenstein or Safety Valve?*, 26 Can.-U.S. L.J. 107, 109 (2000). Because Article 1139 does not carve out either goodwill or market access from the covered types of intangible property, it must be construed to include goodwill and market access.[26]

This interpretation also accords with the intent and purpose of the NAFTA Parties to provide as much investment protection as possible:

> If you look at the definition of investment, you will see that it is enormously broad . . . one would be hard-pressed to think of what

[26] Nevertheless, Canada and Mexico argue in their Submissions that goodwill and market access are not investments because they are not explicitly listed in Article 1139. *See* Canada's 4/30/01 Submission ¶ 59, Mexico's 5/15/01 Submission ¶ 19. Their argument misses the point that these economic interests are plainly encompassed within the broad terminology of Article 1139(g) and (h).

> we classically think of as an investment, or a commitment of capital to another territory, and not have that brought within the scope of NAFTA Chapter 11.

Price, *supra* at 109; *see also* United States Talking Points in NAFTA Negotiations, at 2 ("NAFTA needs the broadest possible definitions of investment and investor if we are to achieve our goal of encouraging and liberalizing investment flows among our three countries.").

The history of bilateral investment treaties or BITs, the direct antecedents of NAFTA, further demonstrate the inclusion of goodwill and market access in the definition of "investment." BITs have long adopted broad definitions of investments including intangible property such as intellectual property and goodwill.[27] The Model U.S. BIT, for example, includes intellectual property such as "trade secrets, know-how, and confidential business information," which are no less intangible than goodwill and market share. *See* Dolzer & Stevens, *Bilateral Investment Treaties* at 241. Model BITs of Hong Kong, Germany and Austria, moreover, have specifically included in the definition of "investment" not only intellectual property but also "goodwill." *Id.* at 168, 188, 201. NAFTA's broad inclusion of "intangible" property and economic "interests" should be construed consistent with this settled understanding.

Finally, other NAFTA tribunals have held that the definition of "investment" in Article 1139 includes goodwill and market access. *See Pope & Talbot* (Interim Award June 26, 2000),

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> [27] In general, the coverage of BIT protections is broad given the liberal definition of "investments" . . . . The framers of the Model BIT, . . . were wary of defining the concept of "investment" for fear of excluding any of the variety of potential investment arrangements and contexts that may arise. The BIT approach . . . refrain[s] from imposing a potentially limiting definition of protected "property" . . . . [A]nd should include any legitimate interest having economic value and which is associated with an investment.

K. Scott Gudgeon, *United States Bilateral Investment Treaties, supra*, 113-14.

¶ 96 ("the Tribunal concludes that the Investment's access to the U.S. market is a property interest subject to protection under Article 1110"); *S.D. Myers*, ¶ 232 ("The Tribunal recognizes that there are a number of other bases on which SDMI could contend that it has standing to maintain its [Chapter 11] claim including that . . . its market share in Canada constituted an investment"); *id*. (separate opinion), ¶ 218 (noting that "goodwill" is a "property interest known in law").

Despite the overwhelming evidence showing that "investment" includes goodwill and market access, the United States contends to the contrary. It attempts to restrict the definition of investment to mean "property right" and "property interests." *See* U.S. Mem. at 33. Even apart from the fact that goodwill is a recognized "property" right, that contention ignores the disjunction between Article 1139(g), which covers tangible or intangible "property," and Article 1139(h), which additionally covers "interests arising from the commitment of capital." The United States' argument would improperly reduce Article 1139(h) to surplusage. The United States further errs in claiming that market access is not an "investment" because it cannot "be bought, or sold, pledged, mortgaged, traded or otherwise disposed of." *Id.* at 33-34; *see also* U.S. Reply Mem. at 42. Article 1139 imposes no such requirement. Because customer base is an economic interest "arising from the commitment of capital," it plainly qualifies as an "investment" under Article 1139(h).

The United States also attempts to narrow the definition of "investment" by citing inapposite cases that construe neither Article 1139 nor comparable provisions in antecedent BITs. *See* U.S. Mem. at 34-35, 37-38. For example, *Oscar Chinn* did not involve a BIT but rather the Convention of Saint-Germain and a general principle of international law regarding respect for the vested rights of foreigners. *See Oscar Chinn* (U.K. v. Belg.), 1934 P.C.I.J. (ser. A/B) No. 63, 65, 79, 81; s*ee also Biovilac NV v. E.E.C.,* 1984 E.C.R. 4057, at IV(A)(3) (the right

to property and right to carry on an established business); *Kugele v. Polish State* (Germ v. Pol.), *reprinted in* Ann. Dig. 1931/1932, at 69 (Upper Silesian Arbitral Trib. 1932) (no investment treaty). BITs, however, intended to go beyond those rights granted by customary international law, and grant foreign investors *additional* rights. *See* Dolzer & Stevens, *supra* at 17 ("BIT obligations may be taken not merely as declaratory statements of international law, but as evidence of the parties' intentions to *enhance* international law, granting additional rights to the foreign investor.") (emphasis added). And NAFTA, in turn, adopted an "enormously broad" definition of "investment" that went even beyond those of the BITs.

The United States errs further in attempting to distinguish *Pope & Talbot* on the ground that the MTBE ban only partially precludes market access in the U.S. That distinction is factually wrong, because the denial of market access in *Pope & Talbot* was only partial. *See Pope & Talbot* (Partial Award), ¶ 101 ("While this interference has, according to the Investor, resulted in reduced profits for the Investment, it continues to export substantial quantities of softwood lumber to the U.S. and to earn substantial profits on those sales."). Moreover, the United States' purported distinction of market share from market access is legally irrelevant under the functional standard adopted in *Pope & Talbot*:

> While Canada's focus on the "access to the U.S. market" may reflect only the Investor's own terminology, that terminology should not mask the fact that the true interests at stake are the Investment's asset base, the value of which is largely dependent on its export business. The Tribunal concludes that the Investor properly asserts that Canada has taken measures affecting "investment," as that term is defined in Article 1139 and Article 1110.

Id. ¶ 98. Thus, regardless of whether Methanex's ability to sell methanol in California is described as market access or market share, that interest plainly qualifies as an "investment" under *Pope & Talbot* and under Article 1139.

2. Methanex's Enterprises Were Expropriated

In any event, Methanex U.S. and Methanex Fortier plainly qualify as "investments" capable of being expropriated. The United States does not dispute this point. *See* U.S. Reply Mem. at 39 ("Of course those enterprises are 'investments.'"). Instead, it contends that Methanex never alleged that the MTBE ban expropriated its enterprises. *Id*. Once again, the United States is wrong. In its Draft Amended Claim, Methanex did allege that the ban "had the effect of severely infringing and interfering with Methanex's ability to conduct business in the United States, particularly in the state of California, and *the ability of its U.S. investments, Methanex U.S. and Methanex Fortier, to do the same.*" Draft Am. Claim at 69 (emphasis added).

The United States may ultimately dispute whether that interference rises to the level of an expropriation, but that question obviously cannot be resolved at this stage of the case.

E. Article 1101(1) Does Not Require A "Legally Significant Connection"

Chapter Eleven of NAFTA applies to all "measures adopted or maintained by a Party *relating to*" investors of another Party and their investments. *See* Article 1101(1) (emphasis added). Despite the natural breadth of the term "relating to," the United States insists that Article 1101(1) restricts Chapter 11 to measures with a "legally significant connection" to foreign investors and their investments. Not surprisingly, it fails to cite any authority to support that proposed construction. *See* U.S. Reply Mem. at 43-46; U.S. Mem. at 48-50; *see also* Mexico's 5/15/01 Submission, ¶ 6-7. Instead, the United States asserts that its current litigating position constitutes a "practice" to which this Tribunal must defer. But, as explained above, the United States cannot amend NAFTA simply by asserting in litigation arguments that contradict the Treaty's plain terms.

In any event, there is no settled interpretive "practice" because the proposed requirement of a "legally significant connection" directly contradicts prior U.S. interpretations of the term "relating to." In *United States-Standards for Reformulated and Conventional Gasoline*, the United States observed : "In a normal context, "relating to" *merely suggests any connection or association existing between things.*" Submission of the U.S. (Appellant), 1996 WL 112677 (WTO) *8, ¶¶ 32-33 (footnote omitted) (emphasis added). As discussed below, despite its "normal" meaning, the U.S. argued in *Reformulated Gasoline* for a narrower definition because the phrase defined an exception to a general obligation. In contrast, because Article 1101(1) uses "relating to" to define NAFTA parties' general obligations, there is no reason to give the phrase anything other than its "normal" meaning. Accordingly, the Tribunal should reject the United States newly-minted argument that Article 1101(1) requires a "significant legal connection" between the measure and the investor or investment.

Similarly unavailing is the United States' argument that a treaty waiving a State's sovereign immunity must be read restrictively. That argument has been so frequently and consistently discredited that it needs no extended response. As the *Ethyl Corp.* Tribunal put it: "The erstwhile notion that 'in case of doubt a limitation of sovereignty must be construed restrictively' has long since been displaced by Articles 31 and 32 of the Vienna Convention." *Ethyl Corp. v. Canada*, 38 I.L.M. 708, ¶ 55 (1999) (footnotes omitted).[28]

[28] S*ee also Loewen v. U.S.*, (Jan. 2, 2001) ¶ 51 ("Guided by the[] objectives and principles [of NAFTA], we do not accept the Respondent's submission that NAFTA is to be understood in accordance with the principle that treaties are to be interpreted in deference to the sovereignty of states."); *Amco Asia Corp. v. Indonesia* (Jurisdiction)), 1 ICSID Rep. 389 (1983) (ruling that a convention to arbitrate must be construed not restrictively, but "in a way which leads to find out and to respect the common will of the parties"); *United States v. Iran*, Case A17, 8 Iran-U.S. Cl. Trib. Rep. 189, 207-08 (1985) (Brower, concurring) (noting that Vienna Convention had eliminated the principle of strictly construing limitations on sovereignty, which "was in any event never universally favored").

Following the United States' lead, Canada now suggests that, for a measure to "relate to" an investor or investment, there must be a "significant connection" between the two. *See* Canada's 04/30/01 Submission ¶ 23. But as noted in Methanex's Counter-Memorial, Canada's current position is sharply contradicted by its official statement implementing NAFTA, where Canada acknowledged that "Article 1101 . . . covers measures by a Party . . . that *affect*: investors of another Party" and their investments. Canadian Statement on Implementation, *North American Free Trade Agreements*, Treaties, Vol. 2, Booklet 12A, at 68-69 (1994) (emphasis added); *see also* Methanex Counter-Mem. at 50. The fact that Canada is now urging so drastically different an interpretation of Article 1101(1) demonstrates why litigation positions are an untrustworthy interpretive device.

Canada also suggests that because the WTO has sometimes interpreted the term "relating to" more narrowly than the term "affecting," the former must be given a narrow construction in NAFTA Article 1101(1) as well. *See* Canada's 04/30/01 Submission ¶¶ 17-21. However, the WTO decisions cited by Canada actually support a broad reading of Article 1101(1). For instance, Canada relies on *United States-Standards for Reformulated Gasoline and Conventional Gasoline*, WT/DS2/R (Jan. 29, 1996), and other WTO decisions interpreting the term "relating to" as used in Article XX(g) of GATT. But Article XX(g) creates an *exception* to Member obligations under GATT. As even the United States recognized in *Reformulated Gasoline*, the WTO's approach to interpreting that provision merely reflects the well-established rule that "exceptions to general obligations are to be construed narrowly." *Cross-Border Trucking*, ¶ 219, n.234 (citing, *e.g.*, *Reformulated Gasoline*, *supra*; *United States-Shrimp*, *supra*; *see also Reformulated Gasoline*, U.S. Submission ¶ 32 (because Article XX(g) creates an exception to GATT, its use of the term "relating to" should be read less broadly than in its normal context)).

In sharp contrast, Article 1101(1) establishes the scope of NAFTA Party obligations, not exceptions to those obligations.

Canada also misses the point when it observes that the WTO has given a broader meaning to the term "affecting" as used in the General Agreement on Trade in Services ("GATS"), than it has given the term "relating to" as used in GATT Article XX(g). *See* Canada's 04/30/2001 Submission ¶ 21. Because the term "affecting" as used in GATS is found in a provision creating treaty obligations, WTO tribunals have construed it broadly, rejecting attempts by individual countries to equate "affecting" with the terms "regulating," "governing," or "in respect of." *See Bananas*, (Appellate Body) WT/DS 27/AB/R ¶ 220; *see also id.* (Panel), WT/DS/27/R ¶¶ 7.279-7.781 (1997). The term "relating to" in Article 1101(1) likewise creates treaty obligations. Therefore, under the approach on which Canada itself relies, it must be construed liberally, not restrictively. And, as quoted above, the United States' own analysis of GATT Article XX(g) confirms the point.

Canada further suggests that the term "relating to" covers only measures "primarily aimed at" the investor or its investment. *See* Canada's 4/30/01 Submission ¶ 20. For the reasons outlined above, the suggestion is simply wrong.[29] Yet, even under this restrictive approach, the California measures "relate to" Methanex and its investments because they are "primarily aimed at" eliminating methanol and MTBE from the market and at favoring the domestic ethanol industry. Thus, whether the Tribunal interprets Article 1101(1) "in good faith in accordance with

[29] Canada contends that the Appellate Body in *Reformulated Gasoline* "found that the term 'relating to' [as used in Article XX(g) of GATT] was synonymous with "primarily aimed at'." *See* Canada's 4/00/01 Submission, *supra* ¶ 20. In fact, however, the Appellate Body concluded "that the phrase 'primarily aimed at' is not itself treaty language and was not designed as a simple litmus test for inclusion or exclusion from Article XX(g)." *See Reformulated Gasoline* WT/DS2/AB/R, 1996 WL 227476 at *12. Instead, the *Reformulated Gasoline* Tribunal

the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose," (Vienna Convention art. 31(1)) or accepts Canada's and the United States' attempts to retroactively limit their obligations under Chapter Eleven, the California measures "relate to" Methanex and its investments.

F. Methanex Has Already Suffered Damage

The United States and Methanex agree that California Executive Order D-5-99, Bill 521 and the CARB CaRFG3 Regulations are measures within the meaning of NAFTA. The parties further agree that these measures have resulted in "the establishment of a timetable for the phaseout of MTBE by December 31, 2002." U.S. Mem. at 49; *see also* Methanex Counter-Mem. at 23-25. Methanex has credibly alleged that this "phaseout" has already begun to cause it damage. Under Article 1116 and 1117, nothing further is required.

The United States argues that Methanex has not yet suffered "cognizable" damage or loss. U.S. Reply Mem. at 46. As described above, however, the phaseout of MTBE by integrated refiners and independent gasoline distributors has already begun and has already inflicted damage on Methanex. Furthermore, the ban and ongoing phaseout have already caused a precipitous decline in Methanex's share price. Despite the United States' contrary suggestion, these losses are fully "cognizable" under NAFTA.[30]

(continued…)

ruled that the term "relating to" must "be read in the context of the purposes and objects of GATT, and could be given meaning "by a treaty interpreter only on a case-by-case basis." *Id.*

[30] Methanex has alleged that the California measures have damaged Methanex and its investments by eliminating a sub-market for methanol and lowering the price of methanol, thereby affecting the profitability of Methanex and its investments. Statement of Claim at 12. Methanex has further alleged damage to and loss of a substantial portion of its investments' customer base and goodwill (Draft Am. Claim at 35), as well as damage to the investments Methanex has made in developing the demand for methanol in the oxygenate market. Draft Am. Claim at 36. Methanex's investments include Methanex U.S., Methanex Fortier and the resources it has committed in the United States towards the development and exploitation—for

The United States argues that the admittedly completed measures here are analogous to what the *Ethyl* tribunal described as "an unenacted legislative proposal, which is unlikely to have resulted even in a 'practice.'" *Ethyl* ¶ 67. Ultimately, the *Ethyl* tribunal felt it was unnecessary to decide whether *proposed* legislation was a "measure" under NAFTA because by the time the tribunal was considering the claim, the legislative proposal had become a reality. *Id.* ¶ 69. That question similarly is not presented here, where the measures that Methanex has challenged are also not "proposed," but complete, final, and legally binding.[31]

Finally, the United States' Reply Memorial fails to recognize the broader relevance of the opinion in *Applicability of the Obligation to Arbitrate Under Section 21 of the UN Headquarters Agreement of 26 June 1947*, 1988 I.C.J. 12. In the *Headquarters Agreement* case, the issue was whether a treaty "dispute" existed that would obligate the United States to enter into arbitration. *Id*. ¶ 42. The International Court of Justice rejected the United States' argument that no treaty "dispute" existed because a challenge to the domestic law at issue was pending in a domestic court, stating "a dispute may arise even if the party in question gives an assurance that no measure of execution will be taken until ordered by decision of the domestic courts." *Id*. ¶ 42. Just as the ICJ rejected the United States' assertion in the *Headquarters Agreement* case that its refusal to acknowledge a dispute could defeat an obligation to arbitrate, so too here the Tribunal should reject the United States' claim that its refusal to acknowledge Methanex's accumulating loss and damage somehow prevents the Tribunal from recognizing Methanex's claims. The

(continued…)
its economic benefit—of the demand for methanol and methanol-based MTBE by gasoline refiners and distributors.

[31] The United States has not claimed that Executive Order D-5-99, Bill 521 and the CARB CaRFG3 Regulations are proposed measures. Governor Davis' official action, along with

United States' bold assertion that Methanex "cannot demonstrate . . . .loss or damage" (U.S. Reply Mem. at 46) is a factual contention that cannot properly be resolved at this stage of the case.[32]

Methanex is not required to allege that its loss and damage are complete, but only that a breach of a NAFTA obligation has occurred and that Methanex "has incurred loss or damage by reason of, or arising out of, that breach." Methanex has alleged the breach of three separate NAFTA provisions and is prepared to present overwhelming evidence of the ongoing loss and damage arising out of the breach of those obligations.

G. The Tribunal Has Jurisdiction Over Methanex's Amended Claim Under Both Article 1116 And Article 1117

The United States continues to argue that Article 1116 provides no jurisdiction over Methanex's claims. That argument is now academic because Methanex's amended claim invokes both Articles 1116 and 1117, and the United States acknowledges that Article 1117 provides jurisdiction. *See* U.S. Mem. at 63; U.S. Reply Mem. at 52. Moreover, it is wrong for two reasons.

First, the argument ignores the plain text of Chapter Eleven itself. Article 1116 creates a right of action on behalf of an "investor of a Party," which Article 1139 defines as someone who "seeks to make, is making or has made an investment." An "investment," in turn, is defined to include "(f) an interest in an enterprise that entitles the owner to share in the assets of that

(continued…)
the passage of Bill 521 and promulgation of CARB CaRFG3, are already in place and having a substantial, continuing and increasing impact on Methanex.

[32] The United States has presented its "Cognizable Loss or Damage" argument solely as a challenge to Methanex's Article 1110 expropriation claim. U.S. Mem. at 57; *see also* U.S. Reply Mem. at 46 ("no claim for *expropriation* may be made until the property as issue has actually been taken") (emphasis added). The United States has failed to join a cognizable loss argument to Methanex's Article 1102 and Article 1105 claims. *See* U.S. Reply Mem. at 46, n.61.

enterprise on dissolution." Article 1139. Thus, under NAFTA's express terms, an "investor" includes persons who have made an "investment" in the shares of an enterprise — *i.e.*, shareholders. And, as an investor, a shareholder has the right to bring a claim under Article 1116.

Article 1121 confirms the point. Whenever a claim is brought under Article 1116, both the "investor and, where the claim is for loss or damage to an interest in an enterprise of another Party that is a juridical person that the investor owns or controls directly or indirectly, the enterprise" must waive their rights to pursue local remedies. *See* art. 1121(b). Thus, Article 1121 clearly contemplates shareholders bringing derivative claims under Article 1116.

It is hardly surprising, then, that the investors in *S.D. Myers* and *Pope & Talbot* prevailed under Article 1116, despite asserting claims for their injuries as shareholders. *See* Methanex Counter-Mem. at 42-44.

In any event, Methanex has alleged direct injuries that bring its claim squarely within Article 1116 even the United States' limited construction of that provision. For instance, "Methanex has alleged that *it*, as well as its investments, suffered loss of 'customer base, good will and market for methanol in California and elsewhere,'" including both inside and outside the United States. Methanex Counter-Mem. at 44 (quoting Statement of Claim ¶ 38(i)). The United States simply misreads the complaint in suggesting that Methanex alleges direct injuries solely from the loss of sales *outside* the United States. *See* U.S. Reply Mem. at 52.

H. Methanex's Waivers Satisfy Article 1121

Despite the filing of Methanex's original waiver on December 3, 1999, Methanex's subsequent production of consents and ratifications by Methanex U.S. and Methanex Fortier of the original waiver on September 12, 2000, and Methanex's offer to provide still additional waivers upon this Tribunal's acceptance of its Amended Claim (*see* Draft Outline of Am. Claim

and Draft Am. Claim on Jan. 12, 2001 and Feb. 12, 2001 respectively), the United States claims that Methanex has "inexplicably" failed to file satisfactory waivers. U.S. Reply Mem. at 53. That is incorrect. As Methanex has explained, the Methanex U.S. and Methanex Fortier waivers were effective when Methanex submitted its claim to arbitration on December 3, 1999, based on settled principles of Texas and Delaware agency law. *See* Methanex Counter-Mem. at 52. Furthermore, to put this issue to rest, Methanex U.S. and Methanex Fortier *once again* file the waivers contemplated by Article 1121. *See* Exhibit 5.

The United States errs in suggesting that these waivers cannot cure any technical defect in prior waivers. U.S. Mem. at 78. In *Ethyl*, the investor failed to include written waivers in its notice of arbitration, but submitted them with its statement of claim. *See Ethyl Corp.* ¶ 89. Canada argued that under the terms of Article 1121, the waivers were late and that the tribunal therefore lacked jurisdiction. After examining Article 1121, the tribunal rejected Canada's argument that Article 1121 was intended to have the "drastically preclusive effect" of determining jurisdiction (*id*. ¶ 91) and held that the investor's delayed compliance with Article 1121 had no jurisdictional significance. *Id*.

The *Pope & Talbot* tribunal adopted similar reasoning. In *Pope & Talbot*, the investor had failed to submit *any* waiver, and Canada argued that a subsequent waiver would be untimely. Harmac Award ¶¶ 5-7. The *Pope & Talbot* tribunal rejected that argument:

> [I]t might be argued that the waiver requirement plays a more important role with respect to an investment and that that importance should be respected by making the waiver a precondition to the validity of a claim grounded on injury to the claimant caused by harm to its investment. The short answer to such a contention is that *the investment would likely be subject to the same constructive waiver that would apply to the investor itself*. . . . For these reasons, the *Tribunal is not willing to attribute such importance to the requirement for an investment's waiver in Article 1121(1)(b) as to make that waiver a precondition to the validity of a claim*.

Harmac Award ¶ 17 (emphasis added).

In response, the United States again invokes its refrain that these prior NAFTA decisions are wrong. *See* U.S. Reply Mem. at 54. Instead, it embraces the decision in *Waste Management, Inc. v. Mexico*, ISCID Case No. ARB(AF)/98/2 (June 2, 2000). In that case, a tribunal ordered dismissal because the investor, by word and deed, persisted for 14 months in denying any intention to waive the right to pursue related claims for damages. No remotely comparable circumstances are presented in this case, where Methanex and its investments have consistently sought to effect the necessary waivers from the outset of the case.

I. Methanex Should Be Allowed To Amend Its Statement Of Claim

The Tribunal should allow Methanex's amendments to its Statement of Claim because UNCITRAL rules liberally allow a party to "amend or supplement his claim" unless the Tribunal "considers it inappropriate to allow such amendment having regard to the delay in making it or prejudice to the other party or any other circumstances." *See* Methanex Motion to Amend. Article 20 thus creates a "presumption of amendability," and NAFTA tribunals have, to Methanex's knowledge, always allowed amendments. *See Ethyl Corp.*, ¶ 95; *see also Metalclad* ¶ 67-69; *Pope & Talbot* "Super Fee" Award, ¶ 28. Here, the United States has failed to rebut this presumption.

The United States incorrectly characterizes Methanex's amendments as "new claims." While the Draft Amended Claim supplements Methanex's original claim with additional facts and legal theories, the source and nature of its NAFTA injury remain the same: the damage to Methanex and its investments brought about by California's ban of MTBE. Moreover, to the extent the Draft Amended Complaint incorporates new factual allegations, they are based primarily on newly discovered evidence, which was not reasonably available to Methanex when

the original complaint was filed, concerning a secret meeting on August 4, 1998 between Governor Davis and top officials of ADM.[33]

The United States asserts that Methanex unduly delayed in amending its claim because ADM's campaign contributions to Governor Davis were disclosed to the public under applicable campaign finance laws. This assertion misses the point because Methanex objects not only to ADM's contributions to Governor Davis, but also to ADM's secret meeting with the Governor.

Finally, although the United States claims that it is prejudiced by these amendments, it fails to explain the nature of that prejudice. Clearly, the fact that the claim may be more difficult for the United States to defend does not constitute "prejudice" within the meaning of UNCITRAL Article 20. Moreover, this proceeding is still in the jurisdictional phase, *before* the submission of any evidence. At such a preliminary stage, there is nothing to be lost and much to be gained by allowing Methanex to amend its original claim. Indeed, failing to permit such an amendment would cause even more delay by forcing Methanex to resort needlessly to the inefficient alternative of filing a separate arbitration proceeding under NAFTA Chapter 11, thereby triggering the consolidation provisions of NAFTA Article 1126.[34]

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[33] The United States appears to embrace Methanex's contention that the requested amendments "will substantially change the scope and the legal analysis applicable to the United States' jurisdictional objections." Methanex Submission (Dec. 22, 2000) at 6; *see* U.S. Reply Mem. at 56. However, the requested amendments will not substantially alter the scope of the merits hearing. As Methanex previously has explained, the amended claim "makes no changes in the operative facts already before the Tribunal, but simply adds and further particularizes the legal and factual bases of the original cause of action." Motion to Amend at 4-5.

[34] The government's unsubstantiated assertion that Methanex's amended claims are "patently baseless" (U.S. Reply Mem. at 55) cannot support a jurisdictional dismissal at this stage of the case.

J. The Tribunal Should Order Production of Relevant Party Submissions

In its May 9, 2000 letter, the Tribunal directed the parties to address Methanex's request for an order requiring the United States to produce Party submissions in all other NAFTA proceedings. In exchange for narrowing its request, Methanex has since obtained a number of the submissions at issue. Although Methanex has learned that additional relevant submissions exist, the United States has neither specifically identified nor produced them. The submissions that Methanex has obtained directly contradict the United States' assertion that the Parties' recent litigation positions are "subsequent practices" for purposes of interpreting their NAFTA obligations. *See supra* at pp. 37, 43, 60. Because all of the Parties have now joined together in that assertion, they should be required to produce the evidence necessary for the Tribunal to fully consider and fairly decide the issues they have raised. Indeed, anything less would violate due process. Accordingly, Methanex respectfully asks the Tribunal to compel the Parties to produce the requested evidence or, in the alternative, to strike all of their related arguments.

CONCLUSION

For all the these reasons, Methanex submits that the Tribunal should allow it to file an amended claim substantially in accordance with Methanex's February 12, 2001 Draft Amended Claim, reject the United States' contentions on jurisdiction and admissibility, and schedule briefing and argument on the merits.

May 25, 2001

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IN THE ARBITRATION UNDER
CHAPTER 11 OF THE NORTH AMERICAN FREE TRADE AGREEMENT
AND UNDER THE UNCITRAL ARBITRATION RULES
BETWEEN

METHANEX CORPORATION,

Claimant/Investor,

and

THE UNITED STATES OF AMERICA,

Respondent/Party.

CLAIMANT METHANEX CORPORATION'S REJOINDER TO UNITED STATES' REPLY MEMORIAL ON JURISDICTION, ADMISSIBILITY AND THE PROPOSED AMENDMENT

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